Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Level 3 Communications, LLC Petition for Declaratory Ruling That Certain Right-of-Way Rents Imposed by the New York State Thruway Authority Are Preempted Under Section 253	Docket No. WC 09-153

REPLY COMMENTS OF THE NATIONAL ASSOCIATION OF TELECOMMUNICATIONS OFFICERS AND ADVISORS AND THE INTERNATIONAL MUNICIPAL LAWYERS ASSOCIATION

Joseph Van Eaton
Matthew K. Schettenhelm
Miller & Van Eaton, P.L.L.C.
1155 Connecticut Avenue, N.W., Suite 1000
Washington, D.C. 20036-4306
(202) 785-0600

Counsel for NATOA and IMLA

Tillman L. Lay
Spiegel & McDiarmid LLP
1333 New Hampshire Ave., NW
Washington, DC 20036
202-879-4000

Of Counsel

November 5, 2009

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SUMMARY

As the FCC evaluates Level 3's Petition to preempt the requirements of the New York State Thruway Authority ("NYSTA") for access to its rights-of-way and conduit network, the Commission should first ask whether it is appropriate to hear such a case at all. There is a pending New York court case regarding Level 3's obligations to NYSTA. That forum is likely better suited to resolve this case. Even if the Commission were to decide the case, it must decide, before reaching any Section 253 issues, whether Section 253 even applies: the Petition presents a narrow question regarding the contractual relationship between the NYSTA and Level 3. The company seeks to use not just the rights-of-way, but the NYSTA-owned network of conduit that runs through it. This type of contractual dispute does not fall within the ambit of 47 U.S.C. § 253, which is concerned only with statutes, regulations and legal requirements and may be disposed of on those grounds.

But in any event, this unique matter should not be used as a vehicle for the broader pronouncements concerning Section 253 that some commenters have urged. Such calls are misplaced for at least four reasons. First, the commenters urge the FCC to intervene claiming that there is substantial confusion in the courts as to the meaning of Section 253 – but there is not. While there was some initial confusion, the courts, led by the Eighth and Ninth Circuits, have adopted the same standard for Section 253 cases that is used by the FCC. Second, the record here does not show that broad interpretative rulings are necessary; industry commenters' complaints are not supported by factual submissions, and are contradicted by factual findings in proceedings to which the commenters are parties. Third, Congress made clear that the FCC lacks jurisdiction to assess state or local government right-of-way compensation and management under Section 253(c). And finally, industry commenters' requests for

"clarification" are based on a reading of Section 253 that the FCC and most courts of appeals have rightly rejected.

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The National Association of Telecommunications Officers and Advisors ("NATOA"), through its undersigned counsel, hereby files these reply comments in opposition to the petition ("Petition") filed by Level 3 Communications, LLC ("Level 3") and in response to the opening comments filed in this proceeding.

The International Municipal Lawyers Association ("IMLA") supports NATOA's initial comments (and those filed by the New York State Thruway Association ("NYSTA")) and joins with NATOA in these reply comments. IMLA is a non-profit, nonpartisan, professional organization consisting of more than 3,500 members that has been serving local government attorneys since 1935. The membership is comprised of local government entities, including cities and counties, and subdivisions thereof, as represented by their chief legal officers; state municipal leagues; and individual attorneys who represent municipalities, counties, and other local government entities. Since its establishment, IMLA has advocated for the rights and privileges of local governments, and the attorneys who represent them. IMLA has appeared as amicus curiae on behalf of its members before the United States Supreme Court, in the United States Courts of Appeals, and in state supreme and appellate courts.

BACKGROUND

As explained below, there are substantial questions as to whether the Commission should entertain this case. There is a pending New York court case regarding Level 3's obligations to NYSTA. Further, the Petition presents a narrow question regarding the past, present, and future contractual relationship between the NYSTA and Level 3, as the company seeks to use an NYSTA-owned network of conduit running through NYSTA's rights-of-way. As shown in NATOA's and NYSTA's initial comments, this type of contractual dispute does not even fall within the ambit of Section 253, and may be disposed of on those grounds.

But in the event that the Commission finds it necessary to go further, it should decide the case, if at all, on the specific facts arising out of the Level 3-NYSTA relationship. This matter need not and should not be used as a vehicle for any broader Commission pronouncements concerning Section 253, as some commenters have urged.

The calls for broad pronouncements concerning Section 253 are misplaced for at least four reasons. First, the commenter claim that FCC intervention is needed because there is substantial confusion in the courts as to the meaning of Section 253. That is not correct. While there was some initial confusion, the courts, led by the Eighth and Ninth Circuits, have adopted the same standard for Section 253 cases as the FCC. Second, the record in this matter does not show that it is necessary for the Commission to issue broad interpretative rulings; industry commenters' complaints are not supported by factual submissions, and are contradicted by factual findings in proceedings to which the commenters are parties. Third, Congress deliberately made clear that the FCC lacks jurisdiction to assess state or local government right-of-way compensation and management under Section 253(c). And fourth, industry commenters' requests for "clarification" are based on a reading of the law that the FCC and most courts of appeals have rejected.

I. THE COMMISSION MUST RESOLVE AT LEAST TWO PREDICATE QUESTIONS BEFORE IT CAN REACH ANY SECTION 253 ISSUES.

The Commission faces at least two threshold questions before it can consider reaching the issues raised by the commenters as to proper scope of this proceeding, and as to the merits of this proceeding.

The first threshold question is whether, as a prudential matter, the Commission should hear the case. The comments by the NYSTA indicate that there is a pending state court proceeding in which the New York State Attorney General is seeking to recover the amounts Level 3 owes to the NYSTA.[1] Obviously, Level 3 can raise before that court every Section 253 claim its Petition raises here. *City of Rome v. Verizon Communications Inc.*, 362 F.3d 168, 179 (2d Cir. 2004). A court proceeding will permit the parties to test evidence and claims through discovery, including, for example, the unsupported claims by Level 3 that the contracts here are contracts of adhesion. As neither NYSTA nor Level 3 contends that the New York courts are interpreting Section 253 in a manner that is fundamentally inconsistent with the Commission's prior cases, directing Level 3 to raise its claims before the state court would preserve Commission resources. But in any case, as a preliminary matter, the Commission must decide whether it should proceed with this case at this time; this will permit the parties, among other things, to address questions regarding procedures, and in particular whether this matter should be subject to formal adjudicatory hearing processes.

Presently, this case is moving forward on two tracks. One track (at the Commission) is subject to ex parte communication, contains no mechanisms for discovery, and includes a record

[1] Opposition of New York State Thruway Authority ("NYSTA Opp.") at 13.

that is replete with conflicting assertions by the parties (as the NYSTA opposition demonstrates), and that is also (as we show below) filled with unsupported, unverified, and inaccurate claims by industry commenters. The second track, before the court, is proceeding along a traditional judicial path that will allow resolution of evidentiary disputes and state and federal law claims. Given the potential significance of the issues in this proceeding, it is important for the Commission to ensure these two paths are not conflicting.

The second threshold question is whether this case actually implicates Section 253 at all. As NATOA explained in its initial comments, and as the NYSTA comments affirm, this case is first and foremost a contract case about access to conduit, not rights-of-way. Contracts are not subject to preemption under Section 253 – at least where the contract mainly concerns proprietary interests of state and local governments, as opposed to regulatory concerns, and none of the commenters show otherwise. Before the Commission can even consider reaching the substance of Level 3's Section 253 claims (much less the broader assertions about Section 253 by industry commenters), it must carefully consider the relationship between Level 3 and NYSTA. In doing so, the Commission should act cautiously given both the practical and constitutional implications of effectively requiring that a state government be bound by a contract with a price term for access to property of zero. (As NATOA explained in its initial comments, because the relationship between Level 3 and NYSTA is contractual, if the FCC were to preempt the price term as Level 3 urges, the NYSTA will have no means for charging for the rights to property and conduit granted by the contract.)

NATOA and IMLA believe the better course is for the Commission to defer to the state court. If it does not do so, it should dismiss the case because it involves primarily contractual issues.

II. THE FCC SHOULD RESIST CALLS TO EXPAND THIS PROCEEDING BEYOND ITS FACTS.

A. If Not Dismissed, the Petition Should Be Resolved Narrowly.

1. This case should be dismissed, or decided narrowly on its facts.

The record reveals a highly complex contractual relationship between NYSTA and Level 3 that involves access to rights-of-way and to a conduit/fiber network owned by NYSTA that runs the length of a limited-access highway. Level 3 is asking not only that it be granted free access to rights-of-way. It also demands that it be granted rights to enter onto the highway at points of its choosing and to cut into a conduit system. Those rights cannot possibly be granted to all (indeed, the NYSTA lacks authority to provide unlimited entry points given federal highway requirements). The issues here are not regulatory, but contractual, and should be disposed of on that basis, for reasons discussed in NATOA's initial comments and above.

Should the Commission nevertheless be unwilling to dismiss on that ground, the Petition should be dismissed on the separate ground that the FCC lacks jurisdiction over Section 253(c), as discussed in Part III. But should the Commission find it must reach any aspect of the merits of this case, it should do so only on the narrow ground of the specific facts concerning the Level 3/NYSTA dispute.

This case is fact-specific, involving a type of roadway that is different from typical streets, and facilities – state-owned conduit and fiber – not typically involved in a Section 253 case. Level 3 refers to a series of contracts with NYSTA to which its predecessor-in-interest agreed nearly a decade ago, and proceeds to make the novel argument that these agreements — its own agreements – "prohibit or have the effect of prohibiting" the company from providing service. The contracts allow Level 3 to access not only the rights-of-way, but also the conduit and network that burdens those rights-of-way. *See, e.g.*, Pet. Exh. 15 (Rider at A.1 ("NYSTA shall permit Williams to connect a 96 fiber cable in each of two innerducts to the ROW at RT

9J")).[2] The fees about which Level 3 specifically complains were a modification to an agreement that provided entrance to and exit from the NYSTA/Adesta conduit at specified points. It is hard to understand how a contract modification that allows Level 3 to have conduit access rights it otherwise would not have had could be prohibitory, but at the very least, any analysis on the merits would require the Commission to conduct a detailed analysis of the transaction as a whole, considering all the benefits obtained by Level 3. Level 3 attempts to avoid that analysis by improperly trying to analogize what it is paying to NYSTA to circumstances where a provider only obtains access to streets or other rights-of-way in return for paying a gross revenues-based fee, or a linear foot fee. *See* Pet. Exh. 14. But there is no evidence the parties ever viewed the fees charged in those cases as appropriate, or the rights being obtained in this case comparable, to the situations to which Level 3 alludes. Indeed, there is no indication in the record that the parties ever considered the fees at issue to be exclusively for access to rights-of-way. Because of the nature of the rights sought by Level 3, the record is wholly unsuited for the FCC to undertake a comprehensive analysis of what constitutes "fair and reasonable" compensation or "competitively neutral and nondiscriminatory" right-of-way management under Section 253(c), or a prohibition under Section 253(a).[3]

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[2] We understand that NYSTA now owns the entire conduit system to which Level 3 seeks access. As such, to the extent Level 3 challenges NYSTA's fees going-forward, it seeks to use Section 253 to access not just rights-of-way, but conduit that NYSTA holds in fee.

[3] This is particularly true given the nature of the claims being raised by Level 3. The NYSTA/Level 3 dispute is largely dominated by state law contractual issues. Level 3 maintains that as a matter of New York contract law, the FCC should ignore its own predecessor's pledge to release NYSTA "from any claim it may have with respect to this Permit Agreement or any other agreement it may have with the Authority or Adesta concerning an additional fiber access connection. . .." Petition at 42 (citing *Gillman v. Chase Manhattan Bank*, 534 N.E.2d 824, 829 (N.Y. 1988)). Level 3 further urges the FCC to overlook the company's pledge that the Riders would "not be admissible for any purpose in any connection with any other dispute, claim or litigation." Petition 42; *see* Pet. Exh. 15 (Rider at A.11.). Yet it is hard to understand how these agreements can be ignored; and even Level 3 does not contend that they are "statutes, regulations or legal requirements" within the meaning of Section 253.

Moreover, while NYSTA's and NATOA's filing provide ample grounds for dismissing the Petition, Level 3 substitutes bare allegations for critical facts essential to determining whether the contract between Level 3 and the NYSTA, taken as a whole, could be considered prohibitory. Level 3 claims it was forced to accept a contract, or that the contract was one of adhesion – but offers no facts to support that claim.[4] As NATOA pointed out, Level 3 fails to define the "service" and "geographic" markets that it supposedly has been "effectively prohibited" from serving, failed to provide information sufficient to show that Level 3 had no alternatives to providing service via the access points it seeks, and failed to show that the charges it is paying effectively prohibit its ability to provide any telecommunications service. On its face, the contract appears to enable Level 3 to provide service, by permitting it access to conduit that it would otherwise have to install at its expense. Level 3 never shows that the fees render service uneconomic, a showing the FCC has required in the past. *California Payphone Association Petition for Preemption of Ordinance No. 576 NS of the City of Huntington Park, California Pursuant to Section 253(d) of the Communications Act of 1934*, Memorandum Opinion and Order, 12 FCC Rcd. 14191 (1997) ("California Payphone"). Under these circumstances, not only is there no need for broad legal pronouncements by the Commission; there is a need for careful fact-finding and fact development, unless the Petition is dismissed outright.

2. Procedurally, the case is not a proper vehicle for the FCC to address state or local right-of-way compensation or management more comprehensively.

Not only is the record lacking in basic material facts central to Level 3's claim; it is devoid of any facts that would come close to supporting the more generalized pronouncements regarding Section 253(a) and (c) sought by industry commenters.

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[4] By contrast, NYSTA provides facts that show Level 3's predecessor-in-interest took the lead in negotiating contract terms, and ultimately achieved a result closely approximating what was sought. NYSTA Opp. at 7-9.

The limits of the record should not be surprising. Neither the Petition nor the FCC's public notice provided any indication that the FCC would treat this matter as a general rulemaking under 47 U.S.C. § 253. For example, Level 3's Petition does not criticize market-based, gross revenue, or linear foot fees at all. Instead, Level 3 notes that "prevailing rates for communications rights-of-way typically range from $0.50 to $2.00 per linear foot annually." Petition at 12. Moreover, Level 3 complains that NYSTA's fees bear no relationship to "prevailing market rates," which the company notes as one "plausible measure" of a fair and reasonable fee. Petition at 39 (emphasis added).[5]

Despite this, industry commenters interject general complaints about state and local government property management, and call for comprehensive interpretative changes to Section 253(c). The companies calling for these comprehensive changes cite isolated anecdotes involving the alleged actions of a handful of state and local government actors to support their calls for federal preemption.[6] But, remarkably, the industry commenters did not serve these state and local entities with their comments in order to give those entities an opportunity to respond.[7] In effect, the industry is inviting the Commission to issue declaratory rulings without appropriate notice. As a procedural matter, that invitation must be declined.

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[5] Less than a year ago, Level 3 told the United States Supreme Court that a "ready point of reference for determining the 'reasonableness' of a franchise fee is provided by Title VI of the Act, which limits such fees imposed on cable television providers to five percent of gross revenues." Level 3 Communications, LLC, Petition for a Writ of Certiorari, Case No. 08-626, at 21 n.2 (Nov. 7, 2008) (citing 47 U.S.C. § 542).

[6] *See, e.g.*, Comments of Verizon at 5-7 (discussing Eugene, Oregon); Comments of Qwest at 3-7 (discussing The Elephant Butte Irrigation District; the Maryland-National Capital Park & Planning Commission; the City of Santa Fe, New Mexico; the City of Deming, New Mexico; and the City of Mesa, Arizona).

[7] 47 C.F.R. § 1.1206(a) note 1 ("In the case of petitions for declaratory ruling that seek Commission preemption of state or local regulatory authority. . ., the petitioner must serve the original petition on any state or local government, the actions of which are specifically cited as a basis for requesting preemption.").

3. The anecdotal evidence presented by commenters is more fiction than fact, omitting critical information and factual findings that undermine claims made.

Setting aside procedural issues, commenters provide little reason for revisiting Section 253 broadly, or for setting a national compensation standard – even assuming the Commission had authority to do so.[8] Broadly speaking, industry commenters offer three reasons why they believe it is necessary for the Commission to expand this proceeding.

a. <u>The alleged confusion in the courts regarding Section 253</u>. Commenters argue that courts are in "disarray" as to how to interpret section 253. AT&T Comments at 1. As the Commission itself recently recognized, however, there is no significant interpretive confusion:

> Nor is there a clear conflict among the circuits on the standard for preemption under Section 253(a). The courts of appeals uniformly recognize that the FCC's California Payphone Order, 12 F.C.C.R. 14,191 (1997), prescribes the applicable standard for determining whether a legal requirement has the effect of prohibiting the ability to provide a telecommunications service. Although some circuits have interpreted the Commission's standard through the lens of Auburn's more-preemptive "may" standard—contrary to the approach of the Eighth and Ninth Circuits' decisions here—the conflict is not sufficiently settled or stark to warrant this Court's resolution at this time.
> ***
> The Eighth and Ninth Circuits' interpretation of Section 253(a) appears to be consistent with that of the FCC. In determining whether a state or local requirement has "the effect of prohibiting the ability" of an entity to provide telecommunications services, the Commission has looked to the "practical effect" of the requirement on the entity. Public Util. Comm'n of Tex., 13 F.C.C.R. 3460, 3470 ¶ 22 (1997) (Texas PUC Order). [footnote omitted]. The mere possibility that a state or local requirement might prevent a telecommunications carrier from providing service is not sufficient to violate Section 253(a).

Brief for the United States as *Amicus Curiae* at 9, 11, *Level 3 Communications v. City of St. Louis*, Nos. 08-626 and 08-759 (U.S. filed May 24, 2009).

[8] As shown *infra,* Parts III-IV, the Congress intended to preserve local pricing authority, and rejected language that might have permitted the FCC to establish a national price scheme for access to state property.

Perhaps recognizing that there is no real disarray, AT&T argues that the Ninth Circuit has recently determined that a plaintiff cannot succeed on a Section 253(a) claim unless it is completely prohibited from providing service. The decision referred to is *Time Warner Telecom of Oregon, LLC v. City of Portland*, 2009 WL 965816 (9th Cir. 2009), an unpublished opinion that had already been issued and of which the Commission and Solicitor General were aware at the time the brief quoted above was submitted to the Supreme Court. AT&T's argument is based on one sentence in the opinion, taken out of context. All the Ninth Circuit did was affirm a district court decision in *Time Warner Telecom of Oregon, LLC v. City of Portland*, 452 F. Supp. 2d 1084 (D. Or. 2006). In that case, the district court found, based on ample evidence, that Time Warner had failed to even show that challenged City requirements raised the *possibility* of a prohibition under the since-rejected "may prohibit" test announced in *City of Auburn v. Qwest Corp.*, 260 F.3d 1160 (9th Cir. 2001), *cert. denied*, 534 U.S. 1079 (2002), *overruled in Sprint Telephony PCS, L.P. v. County of San Diego*, 543 F.3d 571 (9th Cir. 2008). Having found Time Warner failed to meet even *Auburn's* overruled "may prohibit" standard, the court properly concluded that Time Warner had failed to show that it had been prohibited or effectively prohibited from providing any service under the stricter *California Payphone* standard. That is all the decision means, and that is why the Ninth Circuit was able to support its conclusion with a citation to the FCC's *California Payphone* standard. There is no indication that the Ninth Circuit, or any other Circuit, is interpreting Section 253(a) inconsistently with *California Payphone*. There remains no need for the Commission to make broad pronouncements about Section 253, particularly because, in the case that is actually before the Commission, both parties appear to agree that *California Payphone* applies.[9]

[9] In effect, AT&T is arguing that the *California Payphone* standard is wrong, and that the Commission should adopt a different standard. But Petitioner Level 3 has not sought such relief in this proceeding.

b. The alleged impact of right-of-way fees on broadband deployment. Industry commenters also argue that requiring them to pay for their use of the rights-of-way inhibits their broadband deployment.[10] As an initial matter, industry commenters never explain how Section 253(a), which reaches only state and local actions that prohibit the provision of "telecommunications service," can be construed to reach what industry concedes are non-telecommunications broadband services. But leaving that aside, industry commenters fail to tell the Commission that in cases where they have been involved, evidence has shown that right-of-way fees do not discourage deployment. Qwest, Time Warner, and Verizon were all involved in litigation in several federal court proceedings involving Portland (Qwest and Time Warner as plaintiffs and Verizon as an amicus) in which claims about the supposedly adverse effect of fees on deployment were analyzed, and did not hold up.

For example, economist Alan Pearce, Ph.D., analyzed the City of Portland's telecommunications market against the markets in various other similarly situated cities, including Charlotte, NC; Cleveland, OH; Denver, CO; and Kansas City, MO. Portland charged providers for the use of its rights-of-way, and required carriers to make "in-kind" contributions. Many of the other cities that Dr. Pearce analyzed did not impose any such right-of-way compensation requirements. Yet Dr. Pearce found: "An examination of the relative numbers of competitive telecommunications service providers in the comparable cities clearly demonstrates that the city of Portland has a relatively large number of competitive providers. . . . ." Expert Report of Alan Pearce, Ph.D., *Time Warner Telecom of Oregon, LLC v. City of Portland*, CV 04-1393 (D. Or. 2005), attached hereto as Exhibit A. That is, there is no evidence that charging fees actually discourages deployment. In fact, Dr. Pearce found that Portland enjoyed more competitive providers than comparable cities that charged no, or lesser, right-of-way fees.

[10] *See, e.g.*, Verizon Comments at 4.

Commenters can muster virtually no federal support for their claims. One commenter mentions a slide in a September 29, 2009 powerpoint presentation by Commission staff that allegedly shows that charges for rights-of-way are a barrier to entry.[11][12] But the slide at most posits that total costs, including utility pole make-ready costs, "may" be a barrier, and the basis for that conclusion is itself unclear.[13] Rather than presenting facts, industry commenters to a large degree rely on nothing more than the simplistic syllogism that if costs for rights-of-way were reduced to permitting fees, they could deploy more. But that proves far too much. Of course, it is also true that in theory, providers could deploy more if charges for electric utility poles attachments were limited to the cost of processing the pole application; or if charges for the use of railroad rights-of-way were limited to the out-of-pocket costs of issuing a permit; or if broadband providers were given free access to any private property they need; or if the federal government returned the fees obtained from wireless spectrum auctions. But Section 253 does not, and could not, compel anyone, including local and state governments, to contribute property to telecommunications service providers for free or at subsidized prices. Section 253 is instead designed to eliminate regulatory barriers to entry, and to shift to a reliance on the market. A policy that allowed access to property at less than fair market value is not consistent with that approach; it would encourage economic inefficiency. A report prepared by Ed Whitelaw, a professor of economics at the University of Oregon, in the Portland proceeding explained why it

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[11] Verizon Comments at 3.

[12] *See* AT&T Comments at 8-9 and n.24.

[13] The facts on which the slide is based are not disclosed. It is not clear, for example, whether the slide is based on facts of the sort presented by Level 3, which combined the costs of access to conduit, right-of-way, and then converted them to a per foot charge *as if* the fees were simply for access to rights-of-way. And considering that commenters do not claim that any of the "abusive" local governments are charging "hundreds of dollars" per foot for access to rights-of-way, it suggests that the complaints are much ado about nothing. Qwest is complaining, for example, that it is abusive to raise a per foot fee from one quarter to fifty cents. Qwest Comments at 3.

was efficient (and pro-competitive) for the City to charge a market-based price for use of its rights-of-way. As he put it:

> Charging a fee to access the City's ROW ensures that the ROW will be used efficiently. The closer the fee approximates the relevant market price, the more likely the ROW will be used in an economically efficient manner, which is a fundamental criterion by which economists evaluate the performance of a market and overall social welfare.

Excerpts from Report of Ed Whitelaw, attached hereto as Exh. B, at 1. In other words, contrary to the suggestion of industry commenters, allowing a fair market value charge *encourages* efficient deployment. There is no evidence that suggests that establishment of a national standard for charging for property (even if it were within the Commission's power), as urged by commenters, is necessary or appropriate.[14]

c. <u>The alleged abusive activities of local governments</u>. Industry commenters' anecdotal complaints about the allegedly abusive behavior of local governments provide no reasoned basis for the Commission to look beyond the narrow facts of this proceeding. As noted above, the complaining industry commenters did not bother to serve their accusatory comments on the objects of their complaints, did not verify or otherwise support their assertions factually, and describe behavior at only at the highest levels of generality.

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[14] Dr. Whitelaw points out that there are many different ways to charge for rights-of-way, and several different ways to come to a reasonable, market-based price. In the *Portland* case, the particular fees at issue were based on gross revenues or lineal feet in the right-of-way. But as his testimony also recognized, charging based on a per fiber or per conduit basis is also a common means of charging for rights of way. This case demonstrates why that might be. As NYSTA points out, in some of the conduit it installed, fiber is leased or owned by several different users. There is a limited amount of conduit available. If users were charged simply on a per foot basis, users would have an incentive to install as much fiber as possible, because that could foreclose entry by others at a relatively low cost. By charging per fiber, NYSTA can either discourage such counterproductive behavior, or encourage those who install fibers to more vigorously seek opportunities to expand the use of fiber. It is certainly a reasonable way to price access, while Level 3 fails to explain why its "zero charge and favored access for me" approach makes any sense at all, or could possibly result in a "fair and reasonable" plan for the sort of special access Level 3 seeks to New York State's conduit system.

Commissioners Baker and McDowell have recently stressed that the FCC must make rules based on hard facts, not anecdotes.[15] Commissioner Copps likewise criticized the FCC's final regulations in the recent video franchising proceeding as being based on "isolated episodes or anecdotal evidence."[16] The anecdotal complaints of industry commenters here offer a good example as to why the Commission cannot rely, and certainly should not act, based on unsupported "anecdote." Indeed, calling what industry commenters have presented "anecdotal" evidence perhaps stretches the point, as even a cursory examination suggests that the industry's "anecdotes" are more accurately characterized as falsehoods and deceptions.

We have already noted, for example, that there is evidence, tested in court, that the Portland market is one of the most competitive in the nation. Claims of "abuse" in Portland and of unreasonable rates have been reviewed and rejected by the courts repeatedly – a point the companies somehow fail to recognize.[17] Verizon's allegations concerning the City of Eugene, Oregon, and its telecommunications ordinance ("Ordinance 20083") are similarly misleading.[18] Verizon's allegations concerning Eugene center around its obvious distaste for Ordinance 20083, which was adopted by the City of Eugene in 1997 in the wake of the enactment of the Telecommunications Act of 1996. The focus of Verizon's attack is the Ordinance's 7% public

[15] *Joint Statement of Robert M. McDowell and Meredith A. Baker on Chairman Genachowski's Speech on Net Neutrality* (September 21, 2009) ("We do not believe that the Commission should adopt regulations based merely on anecdotes, or in an effort to alleviate the political pressures of the day, if the facts do not clearly demonstrate that a problem needs to be remedied."); Statement of Meredith A. Baker, *Commission Seeks Input on Draft Rules To Preserve the Free and Open Internet*, GN Docket No. 09-191 (October 22, 2009) ("As I have said previously, we should not adopt regulations to address anecdotes where there is no fact-based evidence that persuasively demonstrates the presence of a problem."); John Eggerton, *Q&A: FCC's Baker Sounds Alarm Over 'Anecdote'-Based Regulations*, Multichannel News, October 26, 2009.

[16] *Dissenting Statement of Commissioner Michael J. Copps, In re Implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984 as amended by the Cable Television Consumer Protection Act of 1992*, FCC 06-180 (Mar. 5, 2007).

[17] *See, e.g.*, Verizon Comments at 7.

[18] Verizon Comments at 5-6, 7 & 19.

right of way ("ROW") license fee on communications service providers using Eugene's public ROW, and the 2% registration fee (essentially a business privilege tax) on communications service providers (landline or wireline) that provide service to customers in Eugene. As the lever for its attack, Verizon attempts to use Eugene's 1991 limited franchise agreement with MCI ("1991 MCI Franchise"), which pre-dated the 1997 adoption of Ordinance 20083 and expired in 2006, about a year after Verizon acquired MCI.

Verizon's attack on Eugene, which is completely unsworn and unverified, is riddled with inaccuracies and deception and has no place in this proceeding.

First, Verizon conveniently neglects to mention that Ordinance 20083, and its 7% ROW fee and 2% registration fee, have been challenged in court on Section 253 grounds not once, but twice – once in Oregon state court[19] and again in federal court[20] – and *Eugene's Ordinance 20083 fees were upheld in those cases* as consistent with both federal law, and with state law regarding right-of-way fees.[21] The providers were provided ample opportunity to challenge the legality and reasonableness of the ordinance. In other words, both federal and state courts have already rejected the very kind of Section 253 attacks on the Ordinance 20083 fees that Verizon tries to launch here.

Second, Verizon chooses to bury in a footnote (at 6 n.16) the fact that it (through its now subsidiary, MCI) already has its own pending Section 253 court challenge to the Ordinance

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[19] *AT&T Communications of the Pacific Northwest v. City of Eugene*, 35 P.3d 1029, 177 Or. App. 379 (2001); *Sprint Spectrum v. City of Eugene*, 35 P.3d 327; 177 Or. App. 417 (2001); *U.S. West Communications v. City of Eugene*, 37 P.3d 1001, 177 Or. App. 424 (2001), *aff'd in part and vacated in part*, 81 P.3d 702, 336 Or. 181 (2003).

[20] *Qwest Corp. v. City of Portland*, 200 F. Supp. 2d 1250 (D. Or. 2002), *aff'd in part, vacated in part* and remanded, 385 F.3d 1236 (9th Cir. 2004), *cert. denied*, 544 U.S. 1049 (2005), *on remand*, 2006 U.S. Dist. LEXIS 70763 (D. Or. Sept. 15, 2006), *appeal dismissed*, No. 06-36022 (9th Cir. Jan. 6, 2009).

[21] *See, e.g.* 35 P.3d at 1038-1040, 1045-1048.

20083 fees. This, coupled with Verizon's deliberate concealment from the Commission of two court judgments upholding the Ordinance 20083 fees against Section 253 challenge, make Verizon's aim transparent: Verizon is trying improperly to induce the Commission into serving as an unwitting vehicle to sidestep both settled court judgments and pending court litigation.

Third, while it is true that the 1991 MCI Franchise granted MCI the right to install facilities on less than 1,000 feet of Eugene city ROW, was for a 15 year term and provided for a one time payment of $2,300 (Verizon Comments at 5), Verizon overlooks the fact that the Ordinance 20083 license, for which MCI should have applied (but refused) when the 1991 MCI Franchise expired, would have granted substantially broader ROW occupancy privileges to MCI than the 1991 MCI Franchise. The Ordinance 20083 license would have allowed MCI to install facilities on any or all City ROW it wished (subject to permitting and other applicable requirements of Ordinance 20083), rather than being strictly limited to less than 1,000 feet of Eugene city ROW. Thus, the Ordinance 20083 license would, by its nature, be far more valuable than the 1991 MCI Franchise.

Fourth, Verizon also ignores the fact that, by the terms of Ordinance 20083, the 1991 MCI Franchise was grandfathered for its remaining term. As a result, MCI actually enjoyed a preferential ROW compensation advantage over its competitors between 1997, when Ordinance 20083 was adopted, and 2006, when the 1991 MCI Franchise expired. As explained below, MCI's competitors, unlike MCI, were in fact paying Ordinance 20083's 7% ROW fee during that period.

Fifth, Verizon studiously avoids mentioning that the 1991 MCI Franchise provided that the ROW fee set forth therein was not in lieu of, or to be credited against, any other fees, payments or taxes adopted by the City. Pursuant to that provision, MCI paid the Ordinance 20083 2% registration fee to Eugene beginning in 1998, with no apparent ill effect on MCI.

After acquiring MCI, however, Verizon apparently directed MCI to stop paying the 2% fee, and MCI ceased paying the 2% fee at the end of 2006.

Sixth, although Verizon tries to make much of its assertion that MCI would have to pay far more in Ordinance 20083 7% ROW fees than it did under the 1991 MCI Franchise (Verizon Comments at 6 & 19), Verizon, once again, misperceives both Ordinance 20083 and the facts. As noted above, an Ordinance 20083 license, unlike the expired 1991 MCI Franchise, would entitle MCI to install facilities on any and all Eugene city ROW it chooses. Moreover, Verizon ignores the fact that, while MCI may own only limited landline ROW facilities in Eugene, it actually uses far more landline ROW facilities in Eugene than it owns. To earn its Eugene revenue, MCI uses the Eugene ROW facilities of Qwest, the ILEC, as well as presumably CLECs, to originate and terminate its service to Eugene customers. Unlike Verizon, Ordinance 20083 recognizes that reality. Also, Verizon does not mention that under Ordinance 20083, it is entitled to deduct from its Eugene revenue on which the 7% ROW fee is paid, the amount it pays ILECs and CLECs in access or other charges for terminating or originating MCI's Eugene traffic.

Seventh, Verizon's self-serving, unverifiable and uncross-examined claim that it "decided to suspend" the plans of its CLEC affiliate, MCImetro, to build new facilities in Eugene because of the Ordinance 20083 7% ROW fee (Verizon Comments at 6 & n.15) is belied by other facts Verizon chooses not to mention. No fewer than eleven different telecommunications service providers owning ROW facilities in Eugene are licensed under Ordinance 20083 and pay the 7% ROW fee. Ninety-six additional telecommunications service resellers, which use the ROW facilities of others to provide service in Eugene, are registered under Ordinance 20083 and pay the Ordinance's 7% ROW fee, net of the cost they pay to Ordinance licensed carriers for use of their ROW facilities in Eugene. That so many other providers do provide service in Eugene and do pay Ordinance 20083's 7% ROW fee is, Verizon's protestations to the contrary notwithstanding, far more powerful, and reliable, evidence that Eugene's 7% ROW fee does not have a "prohibitive" effect within the meaning of Section 253(a) and is "fair and reasonable" ROW compensation within the meaning of Section 253(c), than Verizon's self-serving and unverifiable claim about MCImetro. What providers actually do, as opposed to what they say in a pleading, is a far more objective and verifiable form of evidence concerning local requirements under Section 253.

Eighth, Verizon complains about the amount of fees it would have to pay under Ordinance 20083, but Verizon fails to inform the Commission that these amounts are substantially less than the amount of ROW fees paid to the City by several other providers, including Qwest, Comcast and AT&T Long Distance.

Ninth, Verizon's claim (Verizon Comments at 7) that "the incumbent local exchange carrier [Qwest] is subject to substantially lower fees [under Ordinance 20083] than Verizon, despite its significantly greater use of the City's public rights of way," is false. Qwest pays the City substantially more in Ordinance 20083 fees than Verizon claims it would have to pay. Moreover, Qwest pays the 7% license fee on its local exchange service revenues, the 2% registration fee on its non-local exchange service revenues, and both fees on Qwest Long Distance's revenues.

Verizon's allegations about Eugene thus are factually wrong and misleading, in addition to being beyond the proper scope of the proceeding, beyond the Commission's jurisdiction, and based on a misinterpretation of Section 253.

Qwest's odd complaints about Deming, New Mexico, also deserve mention. Qwest Comments at 6-7. Qwest complains that Deming instituted criminal proceedings against it when it refused to pay a required fee for occupying the right-of-way.[22] Qwest does not deny that it unilaterally refused to pay the right-of-way fee. Nor do it contend that it was surprised by the court proceeding, or that its failure to pay the fee was inadvertent. What Qwest seems to be suggesting is that, as a big telephone company with far greater resources than a small town, it should be allowed to decide whether to pay or not to pay right-of-way fees, as it sees fit, and that any locality that dares to challenge its unilateral decision not to pay in court ought to be treated as engaged in some sort of objectionable "aggressive" behavior.[23] Considering that Qwest has sued its competitors for what it calls "poaching" on its property, the claim is disingenuous at best.[24]

In sum, none of the anecdotal allegations of industry commenters, either individually or collectively, serves as a plausible basis for expanding this proceeding into broader pronouncements about Section 253, even if one assumes that this proceeding could properly be expanded to reach those matters (which, as discussed above, it cannot). Nor have industry commenters provided any explanation as to why this case cannot be decided based on principles already announced by this Commission, and seconded by the courts.

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[22] The fact that we do not discuss each and every one of industry commenters' other anecdotal allegations does not mean that the allegations are correct. We do not have the means to investigate or discuss all of the allegations. What is clear is that the companies are (speaking generously) taking poetic license with facts.

[23] Qwest Comments at 7.

[24] "Qwest sues, says UTOPIA poaches pole space, "The Salt Lake Tribune (Salt Lake City, UT), June 2, 2005

III. THE FCC LACKS JURISDICTION TO PREEMPT STATE OR LOCAL GOVERNMENT LEGAL REQUIREMENTS UNDER SECTION 253(c).

As NATOA and others[25] showed in opening comments, Congress deliberately removed the mention of subsection (c) from Section 253(d) for a single reason: to remove FCC jurisdiction over right-of-way management and compensation issues. Apart from Level 3, other industry commenters appear to ignore the plain language and legislative history that supports the conclusion that the FCC lacks jurisdiction to decide Section 253(c) cases. That language and history cannot be ignored; the Congressional choice must be respected.

Interestingly, Senator Feinstein and Senator Kempthorne were not merely concerned about the burdens local governments must endure to defend their actions in Washington, DC. They were also concerned about whether the FCC or the local government would be entitled to deference when a court reviews local right-of-way decisions:

> A city appealing an adverse ruling by the FCC would appear before the D.C. Federal Appeals Court rather than in the Federal district court of the locality involved. *Further, the Federal court will evaluate a very different legal question—whether the FCC abused their discretion in reaching its determination.* The preemption will force small cities to defend themselves in Washington, and many will be just unable to afford the cost. By contrast, if no preemption exists, the cable company may challenge the city or State action directly to the Federal court in the locality and the court will review *whether the city or State acted reasonably* under the circumstances.

141 Cong. Rec. S8171 (daily ed. June 12, 1995) (statement of Sen. Feinstein) (emphasis added). When industry commenters argue that the FCC would be entitled to deference in construing Section 253(c),[26] they are, in effect asking the Commission to do precisely what Congress said it did not want the Commission to do.

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[25] *See, e.g.,* NYSTA Opp., Comments of the City of Philadelphia; Comments of the New York City DoITT.

[26] Verizon Comments at 10, 13-14.

Senator Gorton offered the second-degree amendment that removed subsection (c) from Section 253(d). He indicated he agreed with Senator Feinstein and Senator Kempthorne regarding "control by cities and other local communities over their own rights of way, an area in which their authority should clearly be preserved." 141 Cong. Rec. S8212 (daily ed. June 13, 1995). Senator Gorton also clearly explained the effect of his amendment:

> There is no preemption . . . for subsection (c) which is entitled, "Local Government Authority," and which is the subsection which preserves to local governments control over their public rights of way. It accepts the proposition from [Senator Feinstein and Senator Kempthorne] that these local powers should be retained locally, that any challenge to them take place in the Federal district court in that locality and that the Federal Communications Commission not be able to preempt such actions.

Id. at S8213.

Neither Level 3 nor its industry allies make a serious attempt to show otherwise. Level 3 relies on *dicta* in *TCG New York, Inc. v. City of White Plains*, 305 F.3d 67, 75-76 (2d Cir. 2002), which noted that Congress's choice creates a "procedural oddity" by which the appropriate forum would be determined by the defendant's answer, not the complaint. *Id*. at 76. But the Second Circuit proceeded to note the obvious response: Congress, of course, "could choose to apply a different rule under some circumstances." *Id*. The Second Circuit declined to refer the case to the FCC under the "primary jurisdiction" doctrine, and ruled that "relevant FCC decisions are *not* controlling." *Id.* (emphasis added).

Level 3 also argues that the FCC must have jurisdiction to decide Section 253(c) issues, because it is required to preempt when it determines that a state or local government has imposed a "statute, regulation or legal requirement" that violates subsection (a).[27] To decide Section 253(a) issues, they argue, the Commission must be able to decide Section 253(c) issues.

[27] Pet. at 28-29.

That is not the case. First, as the Commission's own decisions demonstrate, there are many Section 253 cases that do not involve Section 253(c), *In re Classic Telephone*, 11 FCC Rcd. 13082, 13100 (1996) (deciding City ordinance violated Section 253(a), and that City defense of ordinance did not raise Section 253(c) issues).

Second, as the Commission, as well as courts, have recognized, both Section 253(b) and (c) operate as "carve-outs" to Section 253(a). Anything that falls within either provision cannot violate Section 253(a) no matter how serious the prohibitory effect. If, as industry comments claim, mentioning Section 253(a) in Section 253(d) necessarily implied that the Commission could decide what fell within Section 253(c), it would follow that it could also decide what fell within Section 253(b). The Commission can of course decide what falls within Section 253(b), but not because of Section 253(d)'s reference to Section 253(a). Rather, the Commission can reach Section 253(b) issues because Section 253(d) explicitly gives it jurisdiction over Section 253(b). Section 253(d)'s reference to Section 253(b) would be superfluous, however, unless its omission of Section 253(c) precludes Commission jurisdiction over subsection 253(c).

Third, Section 601 of the Telecommunications Act only provides for preemption as "expressly provided"; the preemptive provisions of the Act are to be read narrowly. 47 U.S.C. § 152 nt. The absence of a reference to Section 253(c) in Section 253(d) is thus particularly significant, and indicates that the Commission has no authority to decide cases that raise Section 253(c) issues. *See, e.g., Sw. Bell Tel., L.P. v. City of Houston*, 529 F.3d 257 (5th Cir. 2008). Particularly where a Section 253 claim primarily targets right-of-way compensation or management, as Level 3's Petition unquestionably does, the FCC should decline to reach the merits even under subsections over which it arguably has jurisdiction, as any Commission action may be unnecessary.[28]

IV. VERIZON, AT&T, AND OTHERS MISINTERPRET SECTION 253.

A. Even If the Commission Had Jurisdiction To Construe Section 253(c), the Plain Language and Legislative History Make Clear That That "Fair and Reasonable Compensation" Need Not Be Closely Related to, or Restricted to, Municipal Costs.

Some industry commenters urge the Commission to use this proceeding as a vehicle to construe Section 253(c) as limiting "fair and reasonable compensation" to "municipal expenses incurred because of a carrier's deployment of facilities in public rights-of-way."[29]

Even assuming *arguendo*, however, that the Commission had any jurisdiction to construe § 253(c),[30] the industry's position that "fair and reasonable" right-of-way compensation must be restricted, or "closely related," to costs is not only at odds with Section 253(c)'s language and legislature history, but also would embroil courts, the Commission, local governments, and telecommunications providers in precisely the type of tedious and intrusive right-of-way compensation ratemaking proceedings that Congress intended Section 253(c) to avoid.

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[28] Because there can be no violation of Section 253(a) if local requirement falls within the bounds of Section 253(c), there is no reason for the FCC to reach the Section 253(a) "prohibition" question unless it requires some special Commission expertise. In the ordinary case, it will not. In fact, since many, if not most, Section 253(a) issues involve fact-finding, courts, rather than the Commission, are usually better suited to resolve Section 253(a) disputes.

[29] Verizon Comments at 16. *See* Qwest Comments at 13 (ROW fees must be related to "the costs of maintaining the right-of-way"); Time Warner Cable Comments at 7-8 (ROW rents should be "tied . . . to NYSTA's actual costs"); AT&T Comments at 8 (attacking "fees bearing no relation to costs"). By costs, it is clear industry commenters do not include all costs in an economic sense. Verizon appears to argue, for example, that joint and common costs or opportunity costs, should be ignored because they are too difficult to ascertain. These commenters mean to limit costs to incremental out-of-pocket costs, and to shift the value of the public property to themselves.

[30] *See supra*, Part III, *see also* NATOA Comments at 14-16; NYSTA Comments at 14-18; NYC Comments at 1-3.

1. The plain meaning of "fair and reasonable compensation" is not limited to cost reimbursement but instead contemplates rent for use of rights-of-way.

Industry commenters make no serious effort to assess the plain-language meaning of the phrase "fair and reasonable compensation" in Section 253(c). Certainly the common and ordinary meaning of "fair and reasonable compensation" does not connote mere reimbursement of costs. *Black's Law Dictionary* at 283 (6th ed. 1991), for instance, defines the term "compensation" to mean "payment of damages; making amends; making whole; giving an equivalent or substitute of equal value . . . . Consideration or price of a privilege purchased . . . giving back an equivalent in either money which is but the measure of value . . . recompense in value." And *Black's Law Dictionary* at 277 (7th ed. 1999), defines the terms "just compensation" and "adequate compensation" for use of property as "the property's fair market value."

In common parlance, "fair and reasonable compensation," means more than mere cost recovery.[31] It is difficult to believe, for example, that if a municipal government were selling a parcel of land or a vehicle, or leasing office space in a municipal building, any "compensation" the municipality receives for that property would have to be limited to, or demonstrably related to, cost recovery, rather than fair market value. Likewise, we seriously doubt that Verizon or its

[31] Although the Second Circuit suggested that the "statutory language is not dispositive," that court also observed that "payment of rent as 'compensation' for the use of property does not strain the ordinary meanings of any of the words," "commercial rental agreements commonly use gross revenue fees as part of the price term," and "Congress's choice of the term 'compensation' may suggest that gross revenue fees are permissible" under § 253(c). *TCG New York v. City of White Plains*, 305 F.3d 67, 77 (2d Cir. 2002). Moreover, the only example that White Plains gave for "compensation" being synonymous with costs – "'compensatory' damages in tort are designed to precisely offset the costs . . . inflicted by the tort," *id.* – actually supports our reading of "compensation," since compensatory damages clearly can include lost profits. *See, e.g., Humetrix v. Gemplus*, 268 F.3d 910, 918-19 (9th Cir. 2001); *Silver Sage Partners v. City of Desert Hot Springs*, 251 F.3d 814, 821 & n.6 (9th Cir. 2001); *Yeti by Molly Ltd. v. Deckers Outdoor Corp.*, 259 F.3d 1101, 1107 (9th Cir. 2001).

supporting industry commenters would contend that they are entitled only to cost recovery, rather than the prices they charge, as "fair and reasonable compensation" for the services they render.

In enacting Section 253(c), Congress is of course presumed to be aware of previous interpretations of similar language. *Lorillard v. Pons*, 434 U.S. 575, 580-81 (1978). Precedent construing analogous terms supports construing "compensation" to permit recovery of more than costs. The Takings Clause of the Fifth Amendment, for instance, contains the very similar phrase "just compensation." And the law is clear that the "compensation" to which a person is entitled under the Takings Clause is not mere reimbursement of costs, but fair market value. *United States v. 50 Acres of Land*, 469 U.S. 24, 29 (1984). The law is equally clear that local governments, no less than private parties, are entitled to fair market value as "compensation" under the Takings Clause. *Id.* at 31 & n. 15.

Moreover, Section 253(c) was enacted against a backdrop of abundant precedent establishing that the "compensation" to which municipalities have historically been entitled from private businesses, like telecommunications providers, that place permanent, extensive facilities in the right-of-way is rent (often in the form of franchise fees). Those have often been based on the franchisee's gross revenues. In the directly analogous context of cable television franchise fees, for example, the Fifth Circuit held that the 5% franchise fee permitted by 47 U.S.C. § 542 is "essentially a form of rent: the price paid to rent use of rights-of-way." *City of Dallas v. FCC*, 118 F.3d 393, 397 (5th Cir. 1997). More generally, other courts across the nation, including the Supreme Court, have consistently reached the same conclusion for over one hundred years, in the context of both local telephone and local cable television franchises.[32] Indeed, the proposition

[32] *E.g., City of St. Louis v. Western Union Tel. Co.*, 148 U.S. 92, 98 (1893) (franchise fee is rent for use of local rights-of-way); *City of Plano v. Public Utilities Commission*, 953 S.W.2d 416, 420 (Tex. Civ. App. 1997) (gross receipts-based franchise fee is rent for use of local

urged by Verizon -- that fees can be limited to costs because localities are trustees with respect to rights-of-way -- is flatly inconsistent with the Supreme Court's *St. Louis* decision, 148 U.S. at 98. In both the public and private sectors, rent charges based on a percentage of the tenant's gross revenues have long been an accepted and widely used method of calculating rent because gross revenue-based rent provides a reliable measure of the economic value of the leased property.[33]

This, of course, does not mean that fees must be based on gross revenues; see n. 14, *supra*. Charges for local property may vary depending on a wide variety of circumstances. The central point is that the Section 253(c) compensation provision must be interpreted in light of the plain meaning of "compensation" and the historical backdrop of gross revenue-based franchise fees as a permissible form of "compensation" for use of local rights-of-way. There is simply nothing in the language of Section 253(c) (or elsewhere in the Communications Act, for that matter) remotely suggesting that Congress intended for Section 253(c) to alter historical right-of-way compensation methods radically, to limit compensation to cost, or to upset

rights-of-way); *City of Albuquerque v. New Mexico Public Service Commission*, 115 N.M. 521, 854 P.2d 348, 360 (1993) (same); *City of Montrose v. Public Utility Commission*, 629 P.2d 619, 624 (Colo. 1981), *later proceeding*, 732 P.2d 1181 (Colo. 1987) (same); *City of Richmond v. Chesapeake & Potomac Tel. Co.*, 205 Va. 919, 140 S.E.2d 683, 687 (1965) (same); *Pacific Tel. & Tel. Co. v. City of Los Angeles*, 44 Cal.2d 272, 283, 282 P.2d 36, 43 (1955) (same); *Telesat Cablevision, Inc. v. City of Riviera Beach*, 773 F. Supp. 383, 407 (S.D. Fla. 1991) (same); *Group W Cable, Inc. v. City of Santa Cruz*, 669 F. Supp. 954, 962-63, 972-74 (N.D. Cal. 1987), *further proceedings* 679 F. Supp. 977, 979 (1988) (same); *Erie Telecommunications v. City of Erie*, 659 F. Supp. 580, 595 (W.D. Pa. 1987), *aff'd on other grounds*, 853 F.2d 1084 (3d Cir. 1988) (same).

[33] *White Plains*, 305 F.3d at 77. For examples of gross receipts-based franchise fees, *see, e.g.*, cases cited in n. 20, *supra*. *See also* 12 *McQuillin Mun. Corp.* §34.37 at 130 (3d ed. 1995). For examples of private commercial leases where rent is based on the tenant's gross receipts, *see, e.g.*, *Scot Properties, Ltd. v. Wal-Mart Stores, Inc.*, 138 F.3d 571, 572 (5th Cir. 1998) (construing commercial retail lease where rent is based on a percentage of lessee's gross sales); *State of Texas v. Ralph Watson Oil Co.*, 738 S.W. 2d 25, 27 (Tex. Civ. App. 1987) (evidence of sales volume can be used as a factor in determining value of land upon which business sits); *In re Peaches Records and Tapes, Inc.*, 51 B.R. 583, 590 (Bankr. 9th Cir. 1985) (percentage of gross sales is one of the means adopted by the parties to measure the rental value of the property).

preexisting state laws authorizing (and in some cases, requiring) fair market rents for use of public property. In fact, as we now show, the legislative history unequivocally confirms that Congress specifically intended Section 253(c) to give states and localities substantial latitude to set charges for use of public property.

2. The legislative history of Section 253(c) confirms that Congress wanted to preserve, not preempt, local authority to charge rents for use of rights-of-way.

The legislative history of the Barton-Stupak amendment in the House of Representatives is the key to understanding the meaning of "fair and reasonable compensation" in Section 253(c).[34] And if there is one conclusion on which both the proponents and the unsuccessful opponents of the Barton-Stupak amendment agreed, it was that gross revenue-based fees were a permissible form of "compensation" under what is now Section 253(c). The debate began with Rep. Barton, one of the amendment's sponsors, who made clear that one of the primary purposes of the amendment was to prevent just what industry urges here – having the federal government tell local governments how to set compensation levels for local rights-of-way:

> [The Barton-Stupak amendment] explicitly guarantees that cities and local governments have the right to not only control access within their city limits, but also to set the compensation level for the use of that right-of-way . . . . The Chairman's amendment has tried to address this problem. It goes part of the way, but not the entire way. The Federal Government has absolutely no business telling State and local government how to price access to their local right-of-way.[35]

Rep. Fields then rose in opposition to the amendment, complaining that it would allow municipalities to impose on telecommunications providers what he felt were excessive gross

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[34] *See New Jersey Payphone v. Town of West New York*, 299 F.3d 235, 246-47 n.7 (3rd Cir. 2002) (relying on the Barton-Stupak floor debate to interpret § 253(c)); *White Plains*, 305 F.3d at 80 (relying on Barton-Stupak amendment's elimination of "parity" provision to construe § 253(c)).

[35] 141 Cong. Rec. H8460 (daily ed. Aug. 4, 1995) (remarks of Rep. Barton) (emphasis added).

revenue-based fees in the range of "up to 11% percent." *Id*. at H8461 (remarks of Rep. Fields). The amendment's other sponsor, Rep. Stupak, replied, defending gross revenue-based fees:

> Mr. Chairman, we have heard a lot from the other side about gross revenues. You are right. The other side is trying to tell us what is best for our local units of government. Let local units of government decide this issue. Washington does not know everything. You have always said Washington should keep their nose out of it . . . . This is a local control amendment, supported by mayors, State legislatures, counties, Governors.[36]

Tellingly, those who unsuccessfully opposed the Barton-Stupak amendment argued the amendment was unnecessary because the bill's language already permitted localities to charge gross revenue-based fees, unrelated to out-of-pocket costs.[37] The House overwhelmingly adopted the Barton-Stupak amendment by a 338 to 86 vote. *Id*. at H8477.

In short, the legislative history on "fair and reasonable" compensation is unusually clear. It was intended to provide localities flexibility in pricing, and to allow states and localities to charge rents, including rents based on gross revenues. To construe "fair and reasonable compensation" in Section 253(c) to limit fees to costs, as requested by commenters (but not Level 3), would improperly subvert the clear will Congress, as evidenced by Section 253(c)'s plain language and legislative history.

Industry commenters reliance on statements by Sen. Feinstein regarding cost recovery misconstrue the point of the Senator's comments.[38] Sen. Feinstein's comments came in the course of a discussion about *management* of the rights of way, and recognized that one of the aspects of right-of-way management is recovery of costs (such as permitting costs). However, Section 253(c) protects both management *and* compensation. The fact that Sen. Feinstein

[36] *ld.* at H846l (remarks of Rep. Stupak).

[37] *Id*. (remarks of Rep. Bliley)

[38] Verizon Comments at 17.

recognized that cost-recovery is part of right-of-way management actually compels the conclusion that right-of-way *compensation* involves more than cost-recovery. And, as noted above, that is a reading that is perfectly consistent with the Barton-Stupak amendment.

Furthermore, Sen. Feinstein's remarks, and much of the entire Senate floor debate on what is now Section 253, were focused on jurisdictional issues – specifically, whether the Commission should have jurisdiction to resolve disputes regarding rights-of-way compensation and management under Section 253(c) – and not on whether compensation could exceed costs.[39] The House floor debate on the Barton-Stupak amendment (see Part III(A)(2) above) – which conformed the House language to the Senate language – is in fact the critical floor debate on what is meant by "compensation."

B. Verizon and Other Industry Commenters' Proposed Interpretations of Section 253(c) Fail.

Industry commenters urge the Commission to make several other declarations concerning Section 253(c). But in addition to being beyond the Commission's jurisdiction, industry's proposed interpretations of Section 253(c) are fatally flawed.

For example, Verizon's claim (at 16) that ROW fees "are reasonable only if they are closely related to the locality's costs of managing public rights-of-way incurred as a direct result of a carrier deploying facility" is clearly wrong. The suggestion that no middle ground exists between mere reimbursement of costs and compensation that is not "fair and reasonable" defies common sense, for it would mean that virtually all forms of compensation received for use of property or for goods and services in the nation today are not "fair and reasonable."

But Verizon's assertion is also the ultimate in hypocrisy. Verizon and most other ILECs are subject to "price cap" for their local telephone service rates, and most of their rates for other

[39] 141 Cong. Rec. S8170-8176, 8212-8213, 8306-8305 (daily ed. June 12-13, 1995).

services are completely deregulated. Price cap regulation of local telephone rates, now common at both the state and federal levels and typically adopted at the behest of a dominant ILEC like Verizon, is a form of regulatory rate-setting that, unlike traditional rate-of-return regulation, is not tied to the carrier's costs.[40] Thus, unless Verizon is prepared to admit that the regulated rates it charges for local telephone service are also not "fair and reasonable" because they are not set by cost-based rate-of-return regulation, its claim that cost-based rates are the only acceptable basis for determining "fair and reasonable compensation" must be dismissed as disingenuous.

At most, the "fair and reasonable" qualifier in Section 253(c) might be construed as intended to "prevent monopolistic pricing" by local governments from the Section 253(c) safe harbor.[41] But that is not a concern with respect to most local right-of-way fees, for several reasons. As an initial matter, the laws of many states, much like the federal law 5% cap on cable franchise fees in 47 U.S.C. § 542, serve as a legislative check on the imposition of excessive right-of-way compensation by local governments. Moreover, by their very nature, local governments are subject to effective checks on excessive right-of-way requirements that do not exist in the case of private property owners: "methods exist to promote self-correction in the future: citizens can vote out their local representatives." *Charter Communications v. County of Santa Cruz*, 304 F.3d 927, 935 (9th Cir. 2002). That is especially true in the case of right-of-way

[40] *See, e.g.*, P. Huber, M. Kellogg & J. Thorne, Federal Telecommunications Law at § 2.2.3 (2d ed. 1999).

[41] The phrase is from *White Plains*, 305 F.3d at 79. What is meant by this *dicta* is unclear. It is not obvious that the phrase is intended to establish a test for whether pricing is fair and reasonable. The Second Circuit made the statement in rejecting arguments by TCG that, by analogy to (since repudiated) Commerce Clause cases governing taxation of interstate commerce, fees should be limited to cost: The Second Circuit referred to the concern with "monopolistic pricing" in rejecting the argument that Commerce Clause precedent is relevant or compels cost-based pricing. The Circuit went on to say that Section 253 is concerned with "artificially high rates." That, combined with the legislative history, at least suggests that where rates are established through arms-length agreement, or are long-standing, there is little reason for concern.

compensation levels set by local governments, because both telecommunications providers (by their lobbying) and their bill-paying customers (by their votes) have powerful means to let their local elected officials know if they believe a ROW fee is excessive. Finally, as noted in Part IV.A.2 above, Congress' clear and explicit disdain for heavy-handed federal intrusion into how local governments price access to local rights-of-way counsels strongly against any interpretation of Section 253(c) that would transform courts, or the Commission, into right-of-way compensation ratemaking agencies.

As a factual matter, it is not clear that governments have monopoly power with respect to most, if not all, of the rights-of-way they own. And even where they might, it does not follow that governments would ever have the incentive to use such power. With respect to the NYSTA rights-of-way, there is no indication that the NYSTA controls the only statewide rights-of-way in which conduit could be placed. It may simply have been the best alternative for Level 3. That, of course, does not make NYSTA a monopolist. Wireless providers may often install facilities without placing any property in the rights-of-way – municipal property may just be convenient to use. Convenience does not equate to monopoly power.

Moreover, industry commenters' arguments are predicated on the assumption that state and local governments have a profit-maximizing incentive to charge the highest possible rents for access to rights-of-way. That is to say, they implicitly posit that governments will act to maximize revenues from use of rights-of-way, and deter competition, even at the risk of preventing providers from offering modern services and facilities to their communities and residents (Verizon, for example, argues that localities have an incentive to act anticompetitively). As the studies relied upon by the district court in the *Portland* case indicate, the evidence contradicts industry commenters' unsupported assumption.

In the first place, communities and local governments, unlike private sector businesses, have no incentive to maximize right-of-way profits if it results in fewer services, or higher prices, for their residents. In the second, even if one assumed that a community's primary objective were to maximize its total government budget revenues, the local governments would not do so by limiting telecommunications services; it would try to set a fair price that encourages deployment, in order to encourage other businesses (and taxpayers) to come to the community. A local government's incentives are the opposite of the "anticompetitive" incentives posited by Verizon.[42] A locality that discourages modern utility infrastructure by overpricing will (like any other entity that makes bad pricing choices) soon be driven to correct matters. This is not a case, in other words, where there is reason to fear widespread abuse. And of course, there is no evidence in the record here that would support claims of widespread abuse, either specifically or generally. It bears emphasizing what NATOA noted in its initial comments: the NYSTA conduit project *expanded* opportunities for deployment across New York State. If the Thruway wished to "monopolize," the easier course would have been not to build the system at all. It is not an "abuse" or "monopolization" to require Level 3 to pay the fees for the access to the conduit system that it negotiated a decade ago.

Similarly misguided is Verizon's claim (at 18) that, in determining whether a given ROW fee is fair and reasonable, the Commission should conclude that anytime a fee exceeds the fees charged by other localities, it is *per se* unreasonable; while any time that it is equal to the fees set by other communities, it is subject to challenge, as all localities may be charging more than a fair price. While Drs. Pearce and Whitelaw make clear that what is paid to obtain access to a facility by others is relevant, and what is paid in comparable communities may also be relevant, the rule posited by Verizon is really designed to reduce rates to the lowest rate charged by any

[42] Verizon Comments at 15-16; AT&T Comments at 7.

community anywhere – even if one community set rates based on a policy choice to charge nothing for rights-of-way. The notion that a fee in New York is *per se* unreasonable because it exceeds what is being charged in Kansas defies logic. Moreover, the consequences of Verizon's approach are illustrated by Verizon's comments (at 18), where it claims that Gov. Schwarzenegger issued an executive order limiting fees for use of state rights-of-way to cost. Under the Verizon test, Gov Schwarzenegger's executive order becomes the rule for the public property in New York, regardless of what Gov. Paterson may think is the most appropriate policy. In effect, Verizon makes Gov. Schwarzenegger President and Chief Pricer of public property for all of the United States -- until or unless, for example, Gov. Jindal chooses to set rates at a lower level. As silly as that result may seem, it is what Verizon has requested, and what it claims Section 253(c) should be read to mean. To the contrary, as the legislative history demonstrates, Section 253(c) recognizes that right-of-way value, much like real estate values, may vary enormously across the nation. So, too, do state and local law policy judgments about whether an how to assess right-of-way fees on private ROW users and, if so, at what level. Section 253(c) protects the rights of state and localities to set rates individually, and to make those judgments, individually.

Likewise wrong, and hypocritical is Verizon's suggestion (at 16) that the Commission "should declare that discriminatory fees are prohibited to the extent that they exceed the lowest rate charged to any competitor in the locality" and that "the remedy for discriminatory fees should be require localities to lower excessive fees, rather than allowing them to raise fees." Verizon ignores, presumably intentionally, the fact that right-of-way franchise agreements are entered into at different times,[43] and that requiring a locality to be forever wedded to the lowest right-of-way compensation level it historically assessed in a franchise years ago would be

[43] And, in addition, may involve different rights, or different types of property.

contrary to any plausible interpretation of "compensation," even a strictly cost-based one. Verizon apparently wants localities to be locked in to the lowest right-of-way compensation they have historically charged, regardless whether that compensation level may be years, decades, or even centuries old. The hypocrisy of Verizon's position should be obvious. We doubt, for instance, that Verizon would agree that communications service providers' "compensation" for the services they render, or the assets they sell, should be forever frozen at the level they charged in 1890, or even 2006, for that matter. Moreover, it is inconsistent with the legislative history of the Telecommunications Act: Congress specifically rejected the notion that fees should be set at the same level for all providers, and the debate surrounding the Barton-Stupak amendment's rejection of the bill's original "parity" language makes it clear that Congress did not intend to tie right-of-way rents charged today to fees set years, and even decades before. 141 Cong. Rec. at H8460 (remarks of Rep. Stupak) ("The manager's amendment states that local governments would have to charge the same fee to every company …. Because contracts have been in place for many years, some as long as 100 years, if [the Barton-Stupak] amendment is not adopted …, you will have companies in many areas securing free access to public property, and it is simply not fair to ask the taxpayers to continue to subsidize telecommunication companies.").

V. CONCLUSION

For the reasons indicated, the FCC should deny the Petition.

Respectfully submitted,

Joseph Van Eaton
Matthew K. Schettenhelm
Miller & Van Eaton, P.L.L.C.
1155 Connecticut Avenue, N.W., Suite 1000
Washington, DC 20036-4306
(202) 785-0600

Counsel for NATOA and IMLA

Tillman L. Lay
Spiegel & McDiarmid LLP
1333 New Hampshire Avenue, N.W.
Washington, DC 20036
(202) 879-4000

Of Counsel

November 5, 2009

CERTIFICATION PURSUANT TO 47 C.F.R. § 76.6(a)(4)

The below-signed signatory has read the foregoing Reply Comments, and, to the best of my knowledge, information and belief formed after reasonable inquiry, it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification or reversal of existing law; and it is not interposed for any improper purpose.

Respectfully submitted,

November 5, 2009

Joseph Van Eaton

Exhibit A

NOTE: Excerpt excludes attachments

UNITED STATES DISTRICT COURT

DISTRICT OF OREGON

TIME WARNER TELECOM OF OREGON, LLC, an Oregon Limited Liability Company, and **QWEST COMMUNICATIONS CORPORATION,** a Delaware Corporation,

PLAINTIFFS,

v.

THE CITY OF PORTLAND, an Oregon Municipal Corporation,

DEFENDANT.

CV 04-1393-MO

EXPERT REPORT OF ALAN PEARCE, Ph.D.
Information Age Economics, Inc.
202-466-2654

A. INTRODUCTION

1. I am President of Information Age Economics, Inc. (IAE), a Washington D.C.-based research and consulting firm. I founded IAE in March, 1978, after serving for approximately eight years in senior-level positions with the U.S. Government, first as Chief Economist and Special Assistant to two Chairmen of the Federal Communications Commission (FCC), Dean Burch and Richard E. Wiley, then as Chief Economist of the House of Representatives Telecommunications Subcommittee, under the Chairmanship of Cong. Torbert H. Macdonald and Cong. Lionel Van Deerlin, and finally as Senior Telecommunications Economist and Policy Adviser in the Office of Telecommunications Policy, Executive Office of the President. I attended The London School of Economics

and Political Science, University of London, as both an undergraduate and graduate student, and have a Ph.D. in Business and Telecommunications from Indiana University. My resume, litigation experience, and publications are attached.

2. In connection with the preparation of this report, I reviewed the documents listed in the attached Appendix 2: Reference Materials, along with the amended complaint in this case, Judge Jelderks' decision in Qwest v. City of Portland (March 22, 2002), the Ninth Circuit's decision on appeal thereof (October 12, 2004), the Ninth Circuit's decision in City of Auburn v. Qwest, as amended (July 10, 2001), and the FCC's decision in the Pittencrieff case (October 2, 1997). I worked with Michael F. Carlo, M.B.A. in gathering the information used in this report. Mr. Carlo worked under my direction and supervision.

3. Based on my training and my experience in the telecommunications industry, I was asked to express an opinion on the following issues:

a. From an economic standpoint, is there reason to conclude that the statutes, regulations or legal requirements challenged by plaintiffs "may prohibit" entry? I conclude that there is no evidence to suggest that the regulations "may prohibit" entry, based on a comparison with other communities of similar size, and on general economic principles.

b. From an economic standpoint, is there reason to conclude that the City's approach to telecommunications franchising promotes competition? Is there reason to conclude that the existence of the City's IRNE network promotes competition? I answer both questions in the affirmative, based on a comparison of Portland to other Cities, and on data that suggests that

IRNE's entry into the market enhances opportunities for competition. Indeed, an examination of the relative numbers of competitive telecommunications services providers in the comparable cities, listed below in this report, clearly demonstrates that the city of Portland has a relatively large number of competitive providers, representing a significant indication that the city's regulatory policies have not inhibited competitive entry. On the contrary, competitive entry has been enabled by the city's pro-competitive policies. In sum, the City of Portland has fully lived up to the goals and spirit of The Telecommunications Act of 1996.

c. Is there reason to find that the "in-kind" requirements contained in the Portland franchises are part of a "fair and reasonable" compensation package for use of the rights of way in light of industry practices, and are nondiscriminatory and competitively neutral? I conclude that the "in-kind" requirements are fair and reasonable, and fairly common within the telecommunications industry in transactions where one entity provides a resource (whether rights of way or conduit) to another. In-kind "payments" are not new in the telecommunications-information industry having existed as a common business practice since before World War Two. In-kind merely refers to another form of "payment," for example the performance of "free" services and/or the provision or sharing of facilities. Major telecommunications companies, for example BellSouth, Southwestern Bell, and Verizon, among others, publicize websites that specialize in the sharing of conduits and rights of way, where a variety of deals and methods of payment can be struck, see Appendix 2 for a list of carrier websites and pole attachment literature. I also conclude that the requirements imposed upon telecommunications providers here are relatively similar, and are both non-discriminatory and competitively neutral. Moreover, the management of the rights of way program does effectively allow for competition while balancing the interests of the taxpayers in the city of Portland.

B. ASSUMPTIONS UNDERLYING REPORT; TERMS.

4. I have been asked by the attorneys for the City to assume that all the challenges raised by plaintiffs relate to "statutes, regulations or legal requirements," within the meaning of 47 U.S.C. § 253, even though I understand that City contends that several of plaintiffs' challenges raise issues that are not the proper subject of a Section 253 challenge. I have prepared this report consistent with this assumption so that I could address contentions raised by plaintiffs. I have no opinion one way or the other as to the validity of the assumption.

5. I refer to Plaintiff Qwest Communications Corp below as QCC. The term "Qwest" refers to the incumbent local exchange carrier, an affiliate of QCC. I refer to plaintiff Time Warner Telecom of Oregon LLC as "TWTC" or "Time Warner." IRNE is Portland's "Integrated Regional Network."

6. In this report, I summarize my opinions and the current bases for those opinions, based on the information reviewed thus far. As I review additional information I may revise the opinions expressed in this report, add additional opinions, or both.

C. BACKGROUND

7. Section 253 of the Telecommunications Act of 1996 preempts local laws and regulations that "prohibit" or have the "effect of prohibiting" the "ability" of any entity to provide "telecommunications services," subject to certain exceptions spelled out in Sections 253(b) and (c). The term "telecommunications services" refers only to transmission services provided on a common carrier basis. The term does not include a wide variety of services that a lay person might consider telecommunications services, such as Internet access service.

8. Neither the Act nor the decisions of the Ninth Circuit tells us precisely what is meant by the terms "may prohibit" or "effectively prohibit." What is clear is that Section 253 was part of a major rewrite of the nation's telecommunications laws designed to "promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies."

9. This overall goal, read together with the plain language of Section 253 suggests that it is important to keep basic economic principles in mind when determining whether a particular requirement may prohibit or effectively prohibits the ability of an entity to provide telecommunications services - at least where there is no direct evidence that a particular plaintiff actually has been prohibited from providing a service. That is because it is easy to confuse the effects of regulation with the effects of a competitive market. In a competitive market, we assume some companies will fail, for a variety of reasons; that is actually a desirable outcome. Likewise, in a competitive market we expect incumbent local exchange carriers like Qwest and Verizon to lose customers to new entrants. The

fact that companies are going out of business or losing customers does not, in and of itself, tell us whether competition is being inhibited by regulation, or fostered.

10. The FCC has suggested that the relevant issue is whether a challenged regulation "materially inhibits or limits the ability of any competitor or potential competitor to compete in a fair and balanced legal and regulatory environment," See F.C.C. Rec 1735 (October 2, 1997).

D. APPLYING ECONOMIC PRINCIPLES - WHAT MUST ONE SHOW TO PROVE THAT A POLICY MAY PROHIBIT ENTRY?

11. One way to approach the Ninth Circuit's "may prohibit" test would therefore be to consider the basic characteristics of competitive marketplaces, and to adopt tests that are consistent with the operation of those marketplaces.

a. In a competitive marketplace, providers have distinct advantages one over another. Often advantages are accompanied by disadvantages. Companies that "own" facilities may have advantages over companies that "lease" from them, but the former may require substantial upfront capital that lessees do not require. Not only is it difficult, it is inadvisable to remove these so-called advantages because their removal distorts competition, which rewards the most effective provider of services over the long-term, and results in an efficient allocation of resources. This is true whether the competition is between two private entities, or a public and a private entity. For example, municipalities might have certain so-called "tax-free" advantages but are subject to what might be regarded as serious business disadvantages because they are subject to referendum and voting obligations. In this context, it should be obvious that the FCC's reference to a "fair and balanced" *legal and regulatory* environment does not require elimination of economic advantages or disadvantages generally, including those which in a marketplace would flow from control of assets. Policies that involve transactions or behavior similar to that which occurs in competitive markets should not be treated as "prohibitory," except perhaps in cases where the activity would violate the antitrust laws.

b. In a competitive marketplace, individual customers will switch from one provider to another, and, over time, may switch several times. The mere fact of switching is not proof that there are barriers to entry. Of course, when Buyer A chooses Seller A over Seller B, Seller B may feel that it is being "prohibited" from providing service, but it is not in any meaningful economic sense. The choice is the necessary result of the marketplace and is precisely what we want to occur. It is for this reason that in antitrust contexts, one cannot generally show a competitive harm merely by showing a loss of customers. Rather, except in very rare circumstances one must show harm to consumers or product users in the context of a relevant product and geographic market.

c. Nor is it a barrier to entry when sellers and buyers engage in swaps of goods and services, or choose to deal with one another for reasons other than strictly price. In a competitive marketplace, if Buyer A has an asset that Seller A needs or can use, Seller A may well be willing to provide service at a lower, or even at no cost, in order to obtain that asset; the

Seller can and should take into account what the Buyer brings to the table. In a competitive marketplace, Buyers and Sellers may choose to deal with one another even where there are cheaper price alternatives for reasons of quality of service, trust, or other intangibles

d. In a competitive marketplace, competitors pay for resources that are used to provide products or services. In a competitive marketplace, charges for use are not limited to out-of-pocket expenses, but also reflect the value of the property used. Policies that require payment at value are consistent with a "fair and reasonable" marketplace

e. As a basic matter of economics, while an entity that wishes to use property should pay for the use of that property, it does not follow that the owner of the property must also make a payment for its use. Owners are generally entitled to the use of their own property. Hence, the fact that an owner does not pay the same amount for use of its own ROW as does a lessee - even a lessee that competes with the owner - is not, standing alone, prohibitory in an economic sense. Allegations that IRNE uses the ROW with terms and conditions different from others, even if true, would merely reflect a typical condition of ownership. Ownership is merely one among many competitive factors, some of which may favor one or more competitors over others. Policies that recognize differences in ownership, are consistent with a "fair and reasonable" marketplace.

f. In a competitive marketplace, we encourage companies to resolve disputes through contract, and we allow for differences in contract between one customer and another customer. Even in regulated marketplaces, a regulated company and its customers generally are allowed to agree to contract terms, and regulatory agencies are expected to uphold those terms except in exceptional circumstances. This process allows parties to establish terms and conditions that take into account, for example, differences between one customer and another, and changes between the time one contract was signed and another negotiated.

g. In addition to the fee provisions that are at issue in this case, I understand that Qwest and Time Warner are challenging several "non-fee" provisions that the City claims (i) are not prohibitory; and (ii) are protected by subsections of Section 253 that protect from preemption, for example, requirements related to right of way management, and requirements related to compensation for use of the rights of way. My focus at this stage is on the prohibition claims. In deciding whether a non-fee provision is "prohibitory" it is important to recognize that the sort of non-fee provisions at issue here balance competing and complementary interests of government, the public and telecommunications providers. For example, suppose that government did not manage the rights of way in downtown Portland at all, and that as a result, telecommunications providers were able to enter the rights of way at a very low short-term cost. But, if, as a result, downtown streets deteriorated, access to local businesses were blocked, the overall impact could be to reduce the market for telecommunications service in the downtown area. More directly, if the location of facilities in the rights of way is not known, the cost of future entry may increase in terms of the cost of locating facilities, rerouting lines, damage to facilities, and so on. Hence, efficient right of way management will attempt to balance both short term and long term costs. From the standpoint of telecommunications providers, generally it should not be enough to show that a non-fee provision causes it to incur costs, at least absent some quantification that shows that a reasonably efficient company could not remain in the marketplace and comply with requirements. Rather, because right of way management costs may cause short-term inconvenience while yielding substantial long-term benefits, from an economic standpoint to establish a prohibition it should be necessary also to show both that the costs are substantial and that the benefits are outweighed by the costs.

12. Basing a "prohibition" claim on IRNE's entry into the marketplace raises particularly troubling issues. IRNE does not, and is not in a position to provide all the communications services desired by its customers. Rather, IRNE provides important local connections that allow users to communicate with one another more efficiently, to increase usage without substantially increasing expenses and to reach points where services (such as local exchange service, long distance services and Internet services) can be purchased from a variety of competitive providers.

13. One of the traditional problems in the telecommunications marketplace is that incumbent local exchange carriers, like Qwest, have priced services well above the rates that would be expected in a competitive marketplace. They have been able to do so in

part because of control over key elements of the communications network which provide them a unique ability to service certain customers. If IRNE construction of facilities breaks local distribution bottlenecks, it may open the door to additional competition among private companies.

14. As suggested above, in a competitive market, we would expect buyers to be able to switch sellers, and we would expect that buyers might use different strategies - joint purchasing, vertical integration and so on -- to avoid becoming captive customers of companies with market power. To the extent that IRNE allows users to create products tailored to their own requirements (products which may not even be offered by traditional participants in the marketplace) it would enhance competition, not harm it. In a study in the February 2005 issue of Applied Economic Studies, researchers assessed whether public investments in communications networks crowds out private investment. The study showed that no such crowding out occurred and that "the empirical model indicates that municipal communications actually increases private firm entry."[1]

15. In addition, to the extent that IRNE helps Portland schools and governments deliver services (including emergency services) more efficiently, it may enhance the overall attractiveness of the Portland region to companies, and make the area a more attractive market for businesses generally and for telecommunications providers. That is, IRNE may enable schools and governments to communicate and provide services in new ways, without increasing government expenditures. This in turn may enhance the overall health of the Portland region, and increase the overall size of the telecommunications

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[1] George S. Ford, "Does Municipal Supply of Communications Crowd-out Private Commmunications Investment? An Empirical Study. Applied Economic Studies, February 2005. p. 9.

marketplace. To put it another way, the telecommunications marketplace is not static. If IRNE's entry (or Portland's right of way franchising and management policies, or both) help increase the size of the communications marketplace, IRNE's operations will not be prohibitory.

16. With respect to IRNE, plaintiffs' challenge to IRNE should be rejected unless they are able to demonstrate, at a minimum, that IRNE has a long term effect of reducing business opportunities in the telecommunications marketplace in Portland. This research demonstrates the opposite: That the market is growing and thriving. There is also evidence that IRNE has created competitive opportunities.

E. THE RESEARCH: PORTLAND'S CONTRACTS WITH WIRELINE TELECOMMUNICATIONS PROVIDERS

17. The initial aspect of the research involved a review of Portland's existing franchise agreements with Point-to-Point and Competitive Local Exchange Carrier (CLEC) franchisees, and the Temporary Revocable Permit held by Qwest. For each of the contracts and the TRP, specific attention was given to the fee structure (per linear foot or revenue percentage), scope and duration of the contract, sales and leasing provisions, and any "in-kind" requirement provisions, in part because it is my understanding that those issues have been the focus of the disputes in this case, and in part because those provisions are the provisions that directly involve payments to the City in the form of cash, services, or facilities. More specifically, the review focused on:

- Contract start date and term
- Type of rate structure (linear foot vs. revenue percentage)
- Selling and subleasing provisions
- In-kind requirements[2]

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2 All contracts available at Portland Website - http://www.portlandonline.com/index.cfm?c=33150

In assessing the contract provisions, the research detected and tracked the transformation of contracts from basic to increasingly market driven over the period from 1990 through 2005. Generally, the review of the City of Portland's telecommunication franchise agreements finds that the agreements are largely similar:

(a) Exclusive of temporary arrangements, all agreements to date have been for ten years.

(b) Setting aside the Qwest TRP, all agreements with private companies have required that the provider include some element of in-kind remuneration, in the form of incremental ducts for the City's use whenever a provider undertook construction projects. In addition, some of the contracts contain what amount to distinct business deals established where a provider planned construction through a facility that is not under the control of the City (this is true for the QCC contract). It is my understanding the Qwest TRP does not include an "in-kind" provision because of state law limits on the fee that can be charged to Qwest. However, Qwest overall pays a higher amount, in absolute dollars, than does QCC or Time Warner.

(c) The Agreements between the City and IRNE also call for remuneration, and also provide for what might be characterized as "in-kind" rights. There is, however, an obvious and important distinction between an IRNE installation and a private installation. Even without an agreement, it is far from obvious that IRNE would be able to refuse a directive to install facilities on behalf of other city departments, or refuse to share facilities with other City departments.

(d) Point-to-point carriers were required to pay an annual fee based on linear footage included in the contracts. Rates increased each year based on an inflation-related algorithm. All CLEC contracts called for 5% of gross revenues generated as an annual fee.

(e) Starting in 1997, agreements incorporated a provision that the City of Portland would receive 1 % of the revenue generated from the sale of ducts to other providers.

(f) The agreements also began to include a provision giving the City of Portland a percentage of revenue associated with the sub-lease of ducts in 1997. Initially this fee amounted to 1% of associated revenues. In certain contracts, the fee increased to 5%. In other instances, specifically with the CLEC agreements, this provision was not included in more recent contracts:

Summary of Franchise Agreement Provisions

Provider	Type	Start Date	Linear Footage	Cost per Rev. or Lin. Foot	Sell	Lease	In Kind
AT&T Long Distance	Pt-to-Pt	1/15/1990	78,750	$ 3.15	0%	0%	Yes
PT Cable	Pt-to-Pt	10/25/2000	25,200	$ 3.15	0%	0%	Yes
WorldCom	Pt-to-Pt	2/26/1997	5,600	$ 2.80	0%	0%	Yes
Sprint Communications	Pt-to-Pt	9/4/1997	56,084	$ 3.16	0%	0%	Yes
Qwest Communications Corp.	Pt-to-Pt	12/31/1997	14,038	$ 3.01	0%	0%	Yes
WCI Cable	Pt-to-Pt	9/30/1998	60,000	$ 3.11	1%	1%	Yes
360 Networks	Pt-to-Pt	11/12/1998	125,000	$ 3.01	1%	1%	Yes
FTV Communications	Pt-to-Pt	11/12/1998	18,730	$ 3.04	1%	1%	Yes
Will Tel	Pt-to-Pt	11/8/2000	17,100	$ 3.04	1%	1%	Yes
Broadwing Communications, LLC	Pt-to-Pt	11/8/2000	45,000	$ 3.04	1%	5%	Yes
Tyco Networks (U.S.), Inc.	Pt-to-Pt	5/22/2002	110,000	$ 3.12	1%	5%	Yes
MCI Metro	CLEC	10/23/1995		5%	0%	0%	Yes
Electric Lightwave, Inc.	CLEC	8/19/1996		5%	0%	0%	Yes
Enron Broadband Services	CLEC	5/26/1997		5%	1%	1%	Yes
Time Warner Telecom	CLEC	9/4/1997		5%	1%	1%	Yes
Level3	CLEC	1/17/2000		5%	1%	1%	Yes
TCG Oregon	CLEC	2/8/2000		5%	1%	1%	Yes
McLeod USA Telecommunications	CLEC	12/4/2000		5%	1%	5%	Yes
XO Communications	CLEC	12/4/2000		5%	1%	5%	Yes
AboveNet	CLEC	2/13/2001		5%	1%	0%	Yes
All Phase Utility	CLEC	6/20/2001		5%	1%	0%	Yes
OnFiber Communications	CLEC	9/16/2001		5%	1%	0%	Yes
Integrated Network Regional Enterprise (IRNE	CLEC	5/26/2003		5%	1%	5%	Yes with modifications

F. RESEARCH AND KEY FINDINGS: GENERAL COMPETITIVENESS

18. As a next step in our research, we sought to determine whether Portland's telecommunications policies were likely to promote competition or whether instead they may prohibit or have the effect of prohibiting the ability of an entity to provide telecommunications services. We did so by comparing the state of competition in Portland with that in comparable cities. If Portland's markets are as competitive or more competitive than comparable communities, that would be an indication that its policies

result in a "fair and balanced" marketplace that may not prohibit or effectively prohibit entry. Also, and particularly if Portland provides a valuable marketplace for telecommunications providers, there is good reason to defer to the assessments of the value of that marketplace reflected in contracts between the City and telecommunications providers.

The Comparison

19. The first step in identifying a list of comparable cities was to review the U.S. Census Bureau's Statistical Abstract of the United States: 2004-2005.

20. Like many American cities, Portland serves as an economic center for a larger metropolitan area. As an urban core, cities like Portland will provide highly concentrated and efficient operating locales for many industries, including telecommunications. Also, as an economic core for commercial entities, including corporate operations and retail, the urban sector offers significantly greater revenue opportunities for telecommunications service providers, including the ILEC, the CLECs, and Private Point-to-Point companies. Given this economic and business reality, the analysis focused on cities with an overall residential population within 100,000 inhabitants of Portland's 2003 residential population of 539,000. Thus, this study's initial pool of cities comparable to Portland was limited to those cities with residential populations between 439,000 and 639,000 in 2003. This filter resulted in the inclusion of 20 cities in the initial sample.

21. Given the favorable disproportionate contribution that cities like Portland provide in the broader adjacent metropolitan areas, the study then incorporated the population of the overall metropolitan areas of the above referenced sample cities. In this case, the study established a metric for metropolitan areas within an interval of 30% higher and lower than Portland. In 2003, Portland's metropolitan area had a population of

2,040,000. In assessing an interval of 30%,the study identified metropolitan areas with residents from 1,428,000 to 2,652,000 in 2003. This interval size also showed a fairly distinct demarcation from data points beyond the interval.

22. The two demographic filters to identify cities most proximate to Portland in size and economic scope are:

a. Cities with resident populations within 100,000 of Portland's 539,000 inhabitants;

b. Of the cities identified in (a), only those cities with metropolitan areas within a 30% interval around Portland's metropolitan area population.[3]

23. Based on these filters, the cities which are most comparable to Portland for purposes of our analysis are:

Portland, OR	**539,000**	**2,040,000**
Charlotte, NC	***585,000***	***1,437,000***
Cleveland, OH	***461,000***	***2,140,000***
Denver, CO	***557,000***	***2,301,000***
Kansas City, MO	***443,000***	***1,905,000***
Las Vegas, NV	***517,000***	***1,577,000***
Milwaukee, WI	***587,000***	***1,514,000***
Sacramento, CA	***445,000***	***1,975,000***
Virginia Beach, VA	***439,000***	***1,637,000***

24. For a complete list of cities considered, please review Appendix A.

25. Once the comparable cities had been identified, the next phase of research involved contacting each city individually to determine the methodology by which they assess and manage telecommunications right-of-way issues. The research began with a review of publicly accessible information on city-specific Internet sites. At least one

3 U.S. Census Bureau, Statistical Abstract of the United States: 2004 - 2005. Large Metropolitan Statistical Areas - Population: 1990 to 2003 and Incorporated Places with 100,000 or More in Habitants.

representative in each city was contacted. In nearly all cases, the cities cooperated with the research to the best of its ability. The cities provided information on the fee structures used in each location (linear foot, percentage of revenue, etc.), the actual fees being charged, the duration of agreements, and the inclusion of alternate fee types, such as in-kind charges, subleasing fees and sales fees. If further research indicates that any of the information provided to us was in error, we will make appropriate adjustments.

26. In addition to population in a given market, the economic value of a franchise will also be determined by the purchasing power available to the people residing in that market. Given the importance of income level to the provision and purchase of enhanced telecommunication services, the study considered broader economic statistics available through the U.S Department of Commerce's Bureau of Economic Analysis.

27. In several of the communities identified, localities are limited to recovering certain costs by state law. Telecommunications providers may pay little or nothing to use the rights of way in those states. In other communities, the fee structure appeared comparable to Portland. While there are plainly markets where providers pay lower fees, and are not subject to the same type of right of way management regulations, Portland's market is among the most competitive and potentially most lucrative for a telecommunications provider. Additionally, the fees charged by the city of Portland fall within the range of the comparable cities and were applied consistently among Portland's franchisees.

Cities Analyzed

28. *Charlotte, N.C.* The city of Charlotte, North Carolina, has very few procedures in place to manage telecommunications ROW issues. Currently, the city is considering

legislation to formulate a plan to better balance the public interest with the telecommunications industry. The fee for a temporary easement in Charlotte is $500. No additional fees are charged. The city representative acknowledges it can do a better job in managing the process. Without any structure in place, all road repairs and other related costs are borne entirely by the taxpayers, at an annual cost estimated in the millions of dollars. While Charlotte has slightly more providers than Portland, roughly 30 telecommunication providers, Charlotte does not attempt to manage the ROW function in manner which covers the cost of infrastructure degradation or recovery.

29. *Cleveland, OH.* Cleveland, Ohio, does not appear to have a department that addresses telecommunications ROW. No references exist on the city's website nor does anyone within the government bureaucracy seem to know the appropriate contact.

30. *Denver, Co.* Since 2001, the city of Denver has been unable to charge a fair value rent for use of the rights of way and it also does not recover all costs associated with use of the rights of way; it instead charges a nominal fees to cover the costs of administration of the ROW application. Costs associated with infrastructure degradation must be borne by the taxpayers of the city or of the state. Denver has only five active telecommunications companies currently operating in Denver.[4]

31. In 1997, the city of Denver's charged $2.84/ft. for arterial ROW and allowed a provider to choose to pay 5% of gross revenues in lieu of the per foot fee. In subsequent years, this fee was increased in proportion to the Consumer Price Index (CPI). The per foot fee charged by Denver was noticeably higher than that being charged by Portland at the same time.

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4 Conversation with Darrin Zuehlke, Office of Telecommunications, City of Denver, May 19, 2005.

32. In its 1997 policy, Denver also stated that "the city may accept or require in-kind compensation from rights-of-way users in lieu of all or a portion of fixed fees."[5]

33. *Kansas City, MO.* Kansas City, Missouri, relies on legislation from the 1940s, which was modified in the 1960s, to manage its telecommunications and ROW matters. The city requires a nominal business license fee, in addition to requiring 6% of gross revenues for residential accounts and 10% of gross revenues for commercial accounts. Certain service revenues are considered exempt from the fee on gross revenues.

34. Kansas City has not been active in managing the ROW situation since the passage of the Telecommunications Act of 1996.[6] Kansas City currently has roughly 20 telecommunication providers with approval to operate within the city.[7]

35. *Las Vegas, NV.* By Nevada state law, Las Vegas may charge a maximum of 5% of retail intrastate gross revenues as a fee for a business license, franchise or public right-of-way. The City may require provision of in-kind facilities rather than cash payments. Currently, Las Vegas demands the maximum allowable payment of 5% from its providers.[8] The City of Las Vegas has eight franchised providers in its ROW program.[9]

36. *Milwaukee, WI.* The City of Milwaukee, Wisconsin is limited by state law to cost-based fees for use of the rights of way. However, Milwaukee also owns its own conduit system and leases that conduit to telecommunications providers. The rents for

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5 Denver Council Bill No. 612, Ordinance No. 628, 1997. Ordinance was later ruled to be contrary to state constitution in matter City & County of Denver v. Qwest in 2001.

6 Interview with Bill Geary, Kansas City Counsel on April 14, 2005.

7 Interview with Bill Geary, Kansas City Counsel on May 19, 2005.

8 Interview with Christopher Wallace, Franchise Officer, City of Las Vegas, April 7, 2005.

9 Interview with Christopher Wallace, Franchise Officer, City of Las Vegas, May 19, 2005.

conduit are not limited to cost. For conduit that does not involve river crossings, the fees can be up to $2.85 per linear foot per year. The charges for river crossings are significantly higher, up to $105 per linear foot per year.

In addition, if a provider needs to install conduit from the City system to its own conduit system (essentially linking two systems together), or from one City-owned manhole to another (as may occur if City conduit between the two manholes is already full), the provider must (a) deed the conduit installed to the City and (b) install additional conduit for the City, which is also deeded to the City.[10]

37. *Sacramento, CA*. Sacramento, California does not charge telecommunications providers a rent for a franchise to use rights of way. It does impose a cost-based street cut fee, which appears designed to take into account costs that do not appear to be accounted for directly in permitting fees imposed by other communities examined in this study. Sacramento bases its fees on the age of city streets. The fee structure appears to be designed to capture the loss of street life caused by street cuts. In the case of newest streets, the fees can range from $3.50 per linear foot for longitudinal streets up to $7.00 for transverse excavations. For the oldest streets (over 15 years old), the rate is from $1.00 to $2.00 per linear foot. The scale is a sliding scale based on age.[11] Because of limits imposed by state law, the city does not have any franchise agreements with telecommunications providers and does not receive any supplemental revenue once the

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[10] Interview with Randolf Gshwind, Information and Technology Management, City of Milwaukee, April 14, 2005.

[11] Sacramento City Resolution 97-537.

streets have been repaired. Currently, the city has approximately seven telecommunications providers in operation.[12]

38. *Virginia Beach, VA*. Virginia Beach characterizes itself as being subject to a very restrictive state law with regard to telecommunication rights-of-way issues. Virginia Beach believes these restrictions prevent it from imposing a rent for use of the rights of way, or from recovering (through permitting fees) all the costs caused by telecommunications providers who use the rights of way. While telecommunications must apply for a permit before engaging in certain activities in the rights of way, the obligation of the provider is to ensure the right-of-way used is restored. No fee structure exists. The city had imposed a $1 fee per residential and commercial line, but withdrew the charge. The city does not feel it can effectively control costs associated with right of way use given the state legislation.[13] Currently, Virginia Beach has five telecommunications providers in operation.[14]

39. The research suggests that Portland's policies have resulted in very competitive entry compared to other communities.

Comparison to Portland's Business Climate

40. In its "Metro Area and State Competitiveness Report 2004," the Beacon Hill Institute, lists Portland, Oregon, as the third best competitive metropolitan area of the 50 largest metropolitan areas[15] in the United States. The report assessed metropolitan areas

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12 Interview with Dave Colliman, ROW Streets Management, City of Sacramento, May 23, 2005.

13 Interview with Bill Macali, General Counsel, City of Virginia Beach, April 19, 2005.

14 Interview with Bill Macali, General Counsel, City of Virginia Beach, May 23, 2005

15 Virginia Beach is included in the Norfolk metropolitan area.

in the categories of (1) Government and Fiscal Policy, (2) Security, (3) Infrastructure, (4) Human Resources, (5) Technology, (6) Business Incubation, (7) Openness and (8) Environmental Policy. Of the comparable cities included in this report, Portland ranks first overall and in the critical business related categories.[16] In analyzing the core business climate variables included in the Beacon Hill study, this report focuses on ten variables most critical to economic growth. When assessing these variables, Portland also led the comparable cities, with Denver a close second. This data also suggests that Portland has created a competitive environment for telecommunications providers.

	Portland	Denver	Kansas Citv	Charlotte	Milwaukee	VA Beach	Las Veaas	Sacramento	Cleveland
Overall Rating									
Peer Group Rating									
Government Index	4	7	3	1	6	2	5	9	8
Bond Rating	4	6	3	1	7	2	9	8	5
Infrastructure Index	4	3	5	2	6	7	1	9	8
Broadband Penetration	3	5	8	5	5	5	2	1	9
Technology Index	3	1	2	5	6	7	9	4	8
New Patents Issued	1	6	8	2	3	9	3	7	5
Business Incubator Index	4	7	6	8	9	5	3	2	7
Employer Births	3	t	5	7	8	5	2	4	9
New Publicly Traded Cos	2	1	3	5	6	9	4	7	8
Venture Capital Investment	4	2	6	5	8	3	9	1	7

Business Total Peer Group Rating

41. The city of Portland receives its highest marks in its ability to encourage innovation and in creating new businesses. In the 2004 Inc. Magazine list of 500 fastest growing privately held companies, Portland hosted seven of the top 500, leading the other comparable cities by a significant margin.[17]

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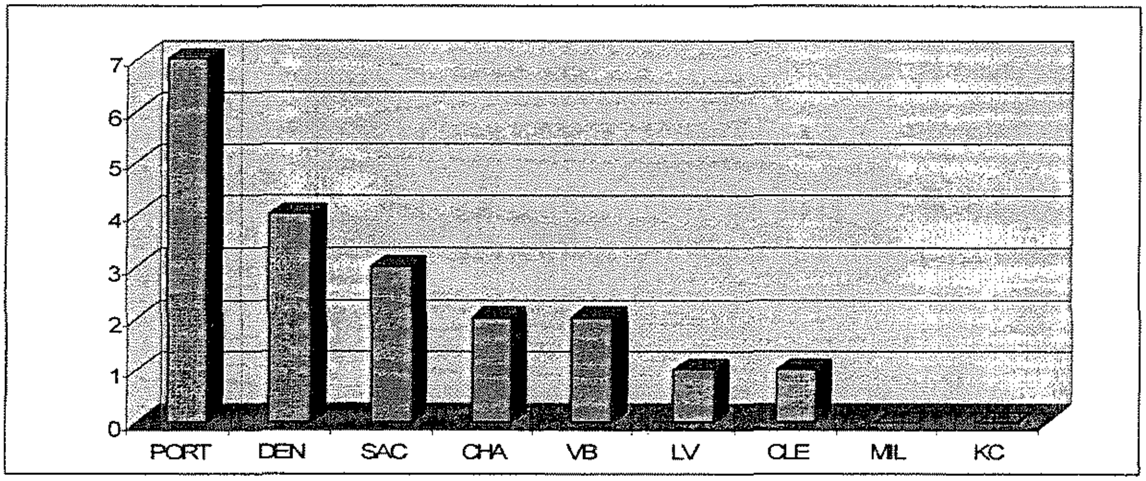
16 "Metro Area and State Competitiveness Report 2004," The Beacon Hill Institute at Suffolk University.

17 Listing of companies is available at www.inc.com/resources/inc500.



Economic Value to Franchisee

42. In determining the value of the telecommunications ROW to a telecommunications provider, the revenue that can be generated in the community is a significant consideration. From the perspective of a franchisee, an agreement for 1,000 linear feet in Manhattan is significantly more valuable than a franchise for 1,000 linear feet in Tupelo, MS. Manhattan has greater population density and significantly higher purchasing power, which will result in an opportunity for the franchisee to realize higher revenues.

43. In this part of the analysis, local economic and demographic data were reviewed and analyzed in an attempt to determine relative value. Overall, telecommunications service revenues are influenced by various factors, including population density, economic growth, the business environment, educational and other skills of the population, employment opportunities, local governments' roles in attracting business, local tax policy, etc., that contribute to the demand for voice, data, video, and other services. Of these variables, population density, population growth and personal income are most readily measured.

44. Using ordinal ranking in these three variables, Denver demonstrates the best combination of the population density, population growth and personal income. Portland, Sacramento and Cleveland follow.

	Population Density	Population Growth	Personal Income	Total Score
1 Denver	6	2	2	10
2 Portland	5	4	3	12
2 Sacramento	3	5	4	12
2 Cleveland	2	9	1	12
5 Las Vegas	4	1	8	13
6 Milwaukee	1	8	6	15
7 Charlotte	7	3	7	17
8 Kansas City	9	6	5	20
9 Virginia Beach	8	7	9	24

45. The importance of population density in assessing the value of the ROW is clear. The more people per linear foot a city has, the more potential customers per linear foot and the greater the expected revenue potential. In a more densely populated area, the firms will gain more revenue per linear foot. In assessing the comparable cities, Portland falls directly in the middle - meaning telecommunications providers in Portland have an opportunity to receive average revenue per linear foot based on the population density variable:[18]

Milwaukee, WI	6,108.2	(residents per square mile)
Cleveland, OH	5,940.7	
Sacramento, CA	4,578.2	
Las Vegas, NV	4,563.1	
Portland, OR	4,013.4	
Denver, CO	3,631.0	
Charlotte, NC	2,414.4	
Virginia Beach, VA	1,768.0	
Kansas City, MO	1,413.1	

18 U.S. Census Bureau, Statistical Abstract of the United States: 2004-2005, Incorporate Places with 100,000 or More Inhabitants in 2003.

46. As metropolitan areas add inhabitants and commercial entities, the value of the linear foot fee structure continues to increase. Since 1990, rates in Portland and other cities have increased in proportion to inflation, during a period of low inflation. In the same metropolitan areas, the number of inhabitants has increased at a much higher rate than overall inflation. In Portland, the base rates for the first franchise agreements were set in 1990. From 1990 - 2003, the comparable cities and their metropolitan areas have all grown:[19]

Las Vegas, NV	**85.6%**
Denver, CO	**30.7%**
Charlotte, NC	**29.9%**
Portland, OR	**26.5%**
Sacramento, CA	**21.3%**
Kansas City, MO	**12.2**
Virginia Beach, VA	**8.7%**
Milwaukee, WI	**4.8%**
Cleveland, OH	**2.2%**

47. In assessing the comparable cities, Portland falls above the median for population growth-meaning telecommunication providers in Portland have an opportunity to receive above average revenue per linear foot based on the population growth variable

48. Finally, once the people have moved to a metropolitan area and are fairly densely populated, a critical remaining piece to creating customers for telecommunications companies is income level. With a higher personal income level, greater expenditures can be made on items such as telecommunications services. According to the Bureau of Economic Analysis (BEA), overall personal income in each metropolitan area for 2002, in millions of dollars, was:[20]

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19 U.S. Census Bureau, Statistical Abstract of the United States: 2004-2005, Large Metropolitan Statistical Areas - Population: 1990 to 2003.

20 Information on personal income is available through Bureau of Economic Analysis www.bea.gov.

Cleveland, OH	**136,756**
Denver, CO	**129,650**
Portland, OR	**85,439**
Sacramento, CA	**75,149**
Kansas City, MO	**74,810**
Milwaukee, WI	**73,730**
Charlotte, NC	**72,648**
Las Vegas, NV	**51,652**
Virginia Beach, VA	**50,180**

49. In assessing the comparable cities and their relative economic scale and purchasing power, Portland falls near the top in personal income - meaning telecommunication companies serving the Portland area have an opportunity to receive significantly more revenue per linear foot based on the metropolitan area's personal income level.

50. In assessing the population density, population growth and personal income, the research demonstrates that the City of Portland offers a strong combination of these three characteristics. When the city's favorable business environment is factored into this analysis, it is clear that Portland offers significant economic value to its telecommunications franchisees.

51. Based on the foregoing, I conclude:

a. There is evidence, based on comparison to the state of competition in other markets, that, in an economic sense, Portland's telecommunications policies are pro-competitive, and do not have and are not likely to prohibit or effectively prohibit entry into the market. This is true as to both the fee and the non-fee provisions.

b. Given this environment, there is little reason to suppose that the contracts entered into by CLECs and point-to-point carriers are unfair, or fail to reflect a fair marketplace valuation of the rights of way in Portland. The agreements themselves suggest that Portland's policies may not prohibit entry or have the effect of prohibiting entry.

c. There is evidence that Portland has created a business environment that provides benefits to telecommunications providers, and could fairly charge a higher fee for use of the rights of way in Portland than is charged in other Cities.

d. In their complaint, QCC and TWTC accuse the City of Portland of creating an environment that is not in the spirit of the Telecommunications Act of 1996. On the contrary, the research clearly indicates that the City of Portland has created an environment that serves the competitive goals of the Act. An examination of the relative numbers of competitive telecommunications service providers in the comparable cities clearly demonstrates that the city of Portland has a relatively large number of competitive providers which is a significant indication that the city's regulatory policies have not inhibited competitive entry. On the contrary, competitive entry has been enabled by the city's pro-competitive policies. In sum, the City of Portland has fully lived up to the goals and spirit of the Act in connection with its management of the ROW and the charges for the use of that right of way, as indicated by the comparison to other markets and by the terms of the contracts themselves.

G. KEY FINDINGS: IN-KIND PROVISIONS

52. A central contention of QCC and TWTC is that the in-kind provisions of their contracts are particularly objectionable, presumably because the City may be able to use

those facilities to avoid purchasing services from QCC and TWTC, and because IRNE may obtain advantages in its efforts to provide services or facilities to other governmental entities. In-kind provisions are commonplace in the telecommunications-information industry, see Paragraph 3 c. above, and a list of Regional Bell websites listed in Appendix 2.

53. This assumes that in the private marketplace, in-kind compensation is uncommon, or that companies refuse to enter into arrangements that may be helpful to a competitor. That is not the case. In reality, each element of in-kind compensation has a monetary value. In the case of the city of Portland, the in-kind compensation was incremental duct being laid in already planned locations. When one views the overall franchisee fees, including the monetary value of the in-kind provisions, the city of Portland certainly falls within the range of the comparable cities.

54. From an economic standpoint, there are several reasons why a company may choose to provide in-kind benefits rather than cash. First, if the in-kind facility is of more value of equal value to a seller than cash, the seller may be willing to take in-kind benefits in lieu of cash; likewise, if a buyer can provide an in-kind facility and reduce cash outlays, it may be worthwhile to provide the in-kind benefit. This is particularly so where (as is true here), the in-kind benefit can be provided relatively cheaply as part of a larger project, where a company may gain economies of scale and volume discounts for the in-kind requirements.

55. A seller and buyer may agree to in-kind arrangements where doing so may reduce costs and potential risks to both parties. Suppose, for example, that a company wishes to place a facility along a railroad ROW, and the railroad may wish to use similar facilities

at some point in the future. If the railroad builds along the ROW later, there may be a risk of harm to the facilities of its lessee, or there may be costs and disruption associated with the installation. The parties could agree at the outset who would bear those costs and risks; or they could agree to terms (such as provision of facilities in-kind) that minimize the risks. In the case of Time Warner Telecomm Inc., the company admits that it "benefits from its relationship with Time Warner Cable, an affiliate of Time Warner, Inc., both through access to local rights-of-way and construction sharing costs." [21]

56. Third, a competitor may agree to arrangements that may have a beneficial impact on the overall marketplace. As I mentioned above, if one impact of IRNE is to make government and educational institutions more efficient, the effect may be to increase the overall market for telecommunications services, or to make it easier to serve certain customers (this is particularly true for companies that do not have facilities throughout the community). There is evidence I discuss in the next section that IRNE has eliminated some bottlenecks to competition, for example.

57. There is no reason to assume that the in-kind provisions are inherently anticompetitive or prohibitory. In-kind provisions may be of particular benefit to new entrants into the marketplace who may wish to reduce cash outlays or other operational risks.

58. Based on a comparison of the contracts for telecommunications franchisees in the city of Portland, the in-kind provisions appear substantially similar, and do not appear to unfairly disadvantage any company.

[21] US Securities and Exchange Commission report, Time Warner Telecom Inc. 10-Q, June 30, 2004, p. 13.

H. KEY FINDINGS: IRNE

59. In an effort to streamline government services, while significantly reducing the growth in telecommunications costs to the city and its taxpayers, Portland introduced the Integrated Regional Network (IRNE) in 2001. The organization's goals include providing a cohesive, redundant communications infrastructure that will allow a multitude of government agencies to communicate on secure fiber lines at high speeds and low cost. Currently, IRNE provides voice and data services to all government bureaus of the City of Portland, along with data services to the following agencies[22]:

- Oregon State Department of Transportation
- Oregon State Department of Administrative Services
- Portland Public Schools
- Multnomah County
- Multnomah Educational Service District
- City of Hillsboro Police Department

60. As I suggested at the beginning, IRNE's entry into the marketplace as a competitor may have a number of pro-competitive effects. The research regarding the general state of competition in Portland certainly suggests that IRNE is not now having an anticompetitive effect. There is evidence that IRNE's presence has actually itself resulted in greater competition in Portland among private companies, thus serving the pro-competitive goals of the Telecommunications Act. For example, TWTC complains in an internal e-mail that it lost a contract to serve Metro to another private provider because Metro was able to take service at a local telecommunications hotel thanks to IRNE.

[22] Documentation provided via factual background summary and interviews with Terry Thatcher, General Counsel, City of Portland and Mark Gray, Portland's Office of Communication and Networking.

61. To understand TWTC's email, it helps to have a little background on the telecommunications industry. Telecommunications providers often bring facilities to one or more central locations in a market where providers can interconnect with one another and exchange traffic. From these "telecommunications hotels" or "meet me" points, individual systems run to various parts of the community. If a retail customer such as a business has its own connection to the hotel, it could potentially buy telecommunications services from a large variety of providers. If the business does not reach the hotel directly, it must either purchase all it services from someone who reaches its offices, or lease connections back to the hotel. It may have very limited choices in this regard, and so it may not be able to obtain services at truly competitive prices. What TWTC is complaining about in the email is that Metro was able to use IRNE facilities to get to a point where it could purchase services at competitive rates. TWTC is complaining that absent IRNE, it would have been the only provider capable of serving Metro. [23]In this instance, stopping IRNE would have reduced competition in the telecommunications marketplace.

62. Another case of enhanced competition has also been brought to my attention. When the Portland School District began using IRNE, instead of the local incumbent telecommunications firm (Qwest Corporation, an affiliate of plaintiff QCC) to obtain access to the local "telco hotel," that also opened more ISP options. In that case, ironically, the District dropped an ISP run by the State of Oregon's government and hired one of the plaintiffs in this case, Time Warner.

[23] Email from Jon Nicholson to Brian Thomas regarding IRNE Service to Metro, August 11, 2004.

63. I have also reviewed the reports of interviews with IRNE customers. All the customers interviewed report that their level of data service has improved and costs have dropped or remained constant since switching to IRNE. Those are results one would wish to see in a competitive market and they appear to be the direct result of IRNE's operations. That is to say, consumers of telecommunications have been benefited by IRNE's presence in the market.

Alan Pearce

Alan Pearce, Ph.D.

Date: 9/1/05

APPENDIX 1: COMPARABLE CITIES ANALYSIS

Comparable Cities Analysis

City/Metro Area	2003 City Pop.		2003 SMSA Pop.	
San Antonio	1,215,000			
San Jose	898,000			
Indianapolis	783,000			
Columbus	728,000			
Austin	672,000			
Milwaukee	**587,000**	**Ft. Worth**	5,590,000	
Charlotte	**585,000**	**Washington, DC**	5,090,000	
Ft. Worth	**585,000**	**Boston**	4,440,000	
El Paso	**584,000**	**Seattle**	3,142,000	
Boston	**582,000**	**Denver**	2,301,000	***Denver***
Seattle	**569,000**	**Cleveland**	2,140,000	***Cleveland***
Washington, DC	**563,000**	**Portland**	2,040,000	***Portland***
Denver	**557,000**	**Sacramento**	1,975,000	***Sacramento***
Nashville	**545,000**	**Kansas City**	1,905,000	***Kansas City***
Portland	**539,000**	**Virginia Beach**	1,637,000	***Virginia Beach***
Oklahoma City	**523,000**	**Las Vegas**	1,577,000	***Las Vegas***
Las Vegas	**517,000**	**Milwaukee**	1,514,000	***Milwaukee***
Tucson	**508,000**	**Charlotte**	1,437,000	***Charlotte***
Albuquerque	**472,000**	**Nashville**	1,371,000	
New Orleans	**469,000**	**New Orleans**	1,318,000	
Cleveland	**461,000**	**Oklahoma City**	1,133,000	
Fresno	**451,000**	**Tucson**	893,000	
Sacramento	**445,000**	**Fresno**	850,000	
Kansas City	**443,000**	**Albuquerque**	765,000	
Virginia Beach	**439,000**	**El Paso**	705,000	
Atlanta	423,000			
St. Louis	332,000			
Pittsburgh	325,000			
Tampa	318,000			
Cincinnati	317,000			
Buffalo	285,000			
Orlando	199,000			
Providence	176,000			

Exhibit B

Note: this excerpt excludes approximately 60 pages of qualifications and prior testimony.

Report of Ed Whitelaw

September 1, 2005

Prepared for

The City of Portland

by

ECONorthwest
99 W. Tenth, Suite 400
Eugene, OR 97401
(541) 687-0051

I. Introduction

My name is Ed Whitelaw. I am a professor of economics at the University of Oregon, where I have taught since 1967. I am also president of ECONorthwest (ECONW), which provides analysis in economics, finance, planning and policy evaluation for businesses and government.

In the matter of Time Warner Telecom of Oregon, LLC (TWT) and Qwest Communications Corporation (QCC) v. the City of Portland (City), the City retained ECONW to evaluate and express an opinion on the prices that the City charges TWT and QCC for using the City's rights-of-way (ROW), and to consider and express an opinion on the Plaintiffs' claims regarding the City's Integrated Regional Network Enterprise (IRNE). The prices are set in the franchise agreements between the City and TWT and QCC. This matter has been brought under the Telecommunications Act of 1996.

I received a Ph.D. in economics from the Massachusetts Institute of Technology. I have testified on economic matters in administrative, legislative and Congressional hearings, and in courts in the Pacific Northwest and elsewhere. A copy of my vita and a table of my prior testimony is attached hereto as Exhibit A. ECONW bills my time at a rate of $375 per hour. No part of this compensation depends upon the outcome of this matter.

Throughout this report, I use "we," "our," and "us" to refer to my ECONW colleagues and me. In their work on this matter, my colleagues have worked under my direction. In this report, I summarize my opinions and the current bases for those opinions, based on the information we have reviewed so far. As we review additional information I may revise the opinions expressed in this report, add additional opinions, or both.

In preparing this report, I have relied on my general training, experience and knowledge regarding economic value and market prices of goods and services, including municipal ROW. We have examined documents produced in this case, reviewed other publicly available information relevant to the case, and interviewed City staff. Appendix B lists the material considered as part of our analysis.

II. Summary of Opinions at this Time

- Charging a fee to access the City's ROW ensures that the ROW will be used efficiently. The closer the fee approximates the relevant market price, the more likely the ROW will be used in an economically efficient manner, which is a fundamental criterion by which economists evaluate the performance of a market and overall social welfare.

- Valuing ROW using comparable transactions is common practice that helps establish a fair market value for ROW.

- TWT and QCC pay fair and reasonable fees to access the City's ROW, and these fees reflect the relevant market value of the ROW.

- Charging in-kind compensation as part of a fair and reasonable compensation package is common practice. TWT and QCC pay fair and reasonable in-kind compensation.

- For access to its ROW, the City does not require compensation from TWT and QCC that is competitively non-neutral or discriminatory.

- IRNE's use of the City's ROW does not constitute unfair competition or antitrust behavior on the part of the City.

- The City holds IRNE to the same standards as it holds other telecommunications firms that use the City's ROW.

- IRNE does not rely on any of the conduit paid in-kind by the Plaintiffs. Conduit paid-in kind by other telecommunications firms amounts to a miniscule proportion of the total value of IRNE and confers no measurable competitive advantage or disadvantage to the City.

- The intergovernmental agreements (IGA) between the City and other jurisdictions to share fiber and other resources do not constitute anticompetitive behavior. Private entities, including telecommunications firms, share resources for a variety of reasons. Telecommunications firms in the Portland market engage in strategic alliances to share ROW access and construction costs. Plaintiff TWT shares ROW access and construction costs in ways similar to the City's alleged anticompetitive behavior.

- IRNE's operation benefits consumers and competition. We know of no evidence to support the Plaintiffs' claim that IRNE's operation represents an abuse of "monopoly control" of the City's ROW.[1]

III. Economic Background

As I understand the Telecommunications Act of 1996, state and local governments have the authority "to require fair and reasonable compensation from telecommunications providers, on a competitively neutral and nondiscriminatory basis, for use of public rights-of-way . . ." (Sec. 253 (c)). In this section I describe economic concepts relating to compensation for use of ROW and competition.

A. Compensation for Use of Public Resources

The Telecommunications Act's provision allowing compensation for use of public ROW is consistent with the economic principle of using prices to allocate scarce resources. From an economics perspective, the City's ROW is a scarce resource. In contrast to "free resources," scarce resources do not "exist in such large quantities that they need not be rationed out

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[1] *See* Complaint for Declaratory Judgment (First). September 28, 2004. In the matter of Time Warner Telecom of Oregon, LLC and Qwest Communications Corporation v. the City of Portland. Page 10, paragraph 18.

among those wishing to use them."[2] Indeed, congestion in the City's ROW—both above ground and below—illustrates that the City's ROW is scarce.

Economic scarcity, however, encompasses more than a constraint on physical capacity. A resource can be scarce in an economic sense even if it can accommodate all users at a given moment in an engineering sense. For example, if the use of a resource by one party imposes costs on other parties, then it is scarce in an economic sense. This conclusion holds whether the affected party is the City, another user of the ROW (a utility, a commuter, a truck driver or anyone else) or a resident (a home owner whose property is affected by utility facilities in the street).

It is because the City's ROW is scarce that charging for its use makes good economic sense. Economic texts describe a relationship between economic scarcity and economic cost, or opportunity cost:

> "Just as scarcity implies the need for choice, so choice implies the existence of cost. ... A decision to have more of one thing requires a decision to have less of something else. It is this fact that makes the first decision costly."[3]

> "It [opportunity cost] concerns the true economic costs or consequence of making decisions in a world where goods are scarce."[4]

The history of cities throughout the world offers compelling illustrations of economic scarcity, opportunity costs, and efficiency in the development of ROW.[5] Examples of cities in

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[2] Samuelson, Paul A. and William D. Nordhaus. 2001. *Economics*, 17th Edition. New York: McGraw-Hill. Page 765. For other authors expressing the same concept, see Hall, Robert E. and Marc Lieberman. 1998. *Microeconomics: Principles and Applications*. Cincinnati, OH: South-Western College Publishing. Page 483; O'Sullivan, Arthur and Steven M. Sheffrin. 2001. *Microeconomics: Principles and Tools*, 2nd Edition. Upper Saddle River, NJ: Prentice Hall. Page 2; Parkin, Michael. 1998. *Microeconomics*, 4th Edition. Reading, MA: Addison-Wesley. Page 42; Tregarthen, Timothy and Libby Rittenberg. 2000. *Microeconomics*, 2nd Edition. New York: Worth Publishers. Pages 3-4.

[3] Lipsey, R., et al. 1990. *Microeconomics,* 9th Edition. New York: Harper & Row, Publishers. Page 4. For other authors expressing the same concept, see Nicholson, Walter. 2000. *Intermediate Microeconomics*, 8th Edition. Fort Worth, TX: The Dryden Press. Page 17; O'Sullivan, Arthur and Steven M. Sheffrin. 2001. Cited previously. Page 24; Parkin, Michael. 1993. *Macroeconomics*, 2nd Edition. Reading, MA: Addison-Wesley. Page 10; Tregarthen, Timothy and Libby Rittenberg. 2000. Cited previously. Page 5;

[4] Samuelson, Paul A. and William D. Nordhaus. 1992. *Economics,* 14th Edition. New York: McGraw-Hill. Page 131. For other authors expressing the same concept, see Hall, Robert E. and Marc Lieberman. 1998. Cited previously. Page 18; McConnell, Campbell R. and Stanley L. Brue. 1996. *Economics*, 13th Edition. New York: McGraw-Hill, Inc. Page 26; Parkin, Michael. 1998. Cited previously. Page 42; Tregarthen, Timothy and Libby Rittenberg. 2000. Cited previously. Page 5.

[5] For various historical descriptions of the development of streets and rights of way, see Abbott, Carl. 1983. *Portland: Planning, Politics, and Growth in a Twentieth-Century City*. Lincoln, NE: University of Nebraska Press; Baldwin, Peter C. 1999. *Domesticating the Street: The Reform of Public Space in Hartford, 1850-1930*. Columbus, OH: Ohio State University Press. Pages 201-203, 207-208; Barrett, Paul. 1983. *The Automobile and Urban Transit: The Formation of Public Policy in Chicago, 1900-1930*. Philadelphia, PA: Temple University Press. Pages 13-14, 49-50; Bridenbaugh, Carl. 1938. *Cities in the Wilderness: The First Century of Urban Life in America 1625-1742*. New York: Alfred A. Knopf. Pages 153-154, 159, 317; Hood, Clifton. 1993. *722 Miles: The Building of the Subways and How They Transformed New York*. New York: Simon & Schuster. Page 84; Pierce,

which I have observed such scarcity and opportunity costs firsthand include Amsterdam, Berlin, London, Rome, Tokyo, Boston, New York, Chicago, San Francisco, Portland (Oregon), Seattle, Vancouver (B.C.), Lima (Peru), Nairobi (Kenya), and Colonia (Yap).

Occupying space in the ROW precludes the City or others from using that same space now and in the future. That is, the three-dimensional space occupied by a given conduit obviously cannot be occupied by another conduit.[6] Also, depending on the specifics of the use, the installation, the maintenance, and the replacement of any given facility in the ROW may create problems for and impose costs on the City and on other users of the ROW.

As applied to the City's ROW, today's scarcity and the resulting opportunity costs will persist tomorrow. That is, today's scarcity manifests itself in those many locations in which the use of the ROW for one service inhibits the use of the ROW or other properties for other services by the same or other users. Clearly, that scarcity and the associated negative, spill-over effects will persist into the future, unless the City experiences a net decrease in ROW use—a result no one has predicted. The negative effects may include increased excavation or construction costs, increased costs associated with design and planning, costs associated with loss-of-service attributed to construction accidents or other damage to services in the ROW, increased travel time for vehicular traffic on the ROW, and lost revenues for business whose customers are inconvenienced by ROW construction.

Like other real-estate assets, the City's ROW yields value to the users of the ROW. Like other real-estate owners, the City charges for use of its ROW. In an economy based on competition, producers and owners of goods and services with economic value typically do not give them away free. In economic markets, prices serve as signals that help society put its resources to efficient use.[7] Not charging for use of the City's ROW would treat it as if it were a free good with no economic value. "A true 'free good' is one which is not scarce... Examples of free goods are rare and perhaps becoming rarer still—sunshine in the Sahara Desert provides one example."[8]

Bessie Louise. 1937. *A History of Chicago: Volume I.* New York: University of Chicago Press. Pages 96, 336; Pierce, Bessie Louise. 1937. *A History of Chicago: Volume II.* New York: University of Chicago Press. Page 325; Quaife, Milo M. 1923. *Chicago's Highways Old and New: From Indian Trail to Motor Road*. Chicago, IL: D. F. Keller & Co. Pages 53-54, 60; Thwing, Anne Haven. 1920. *The Crooked and Narrow Streets of Boston: 1630-1822*. Boston: New England Historic Genealogical Society. Electronic Version; Whitehill, Walter Muir. 1968. *Boston: A Topographical History*, 2nd Edition. Cambridge, MA: The Belknap Press of Harvard University Press. Page 8.

[6] This concept is distinct from the concept of multiple parties sharing a particular fiber or conduit.

[7] *See,* for example, Byrns, Ralph T. and Gerald W. Stone, Jr. 1992. *Economics,* 5th Edition. New York: HarperCollins. Page 71; Nicholson, Walter. 1998. *Microeconomic Theory*, 7th Edition. Fort Worth, TX: Dryden Press. Pages 514-515; Pindyck, Robert S. and Daniel L. Rubinfeld. 2000. *Microeconomics,* 5th Edition. Upper Saddle River, NJ: Prentice Hall. Page 590; Samuelson, Paul A. and William D. Nordhaus. 2001. Cited previously. Pages 27, 291.

[8] Pearce, David W. (ed). 1997. *The MIT Dictionary of Modern Economics*, 4th Edition. Cambridge: The MIT Press. Page 163.

Free access to the City's ROW would fail to impose any market discipline on potential users of the ROW. For example, a price of zero would send an inaccurate signal of the value of the ROW to potential users. Charging a fee helps ensure that the ROW will be used efficiently, that is, that the ROW will not be misused or wasted. Furthermore, the closer the fee approximates the relevant market price, the more likely the ROW will be used in an economically efficient manner, a fundamental criterion by which economists evaluate the performance of a market and overall social welfare.

B. Competitively Neutral and Nondiscriminatory

As I understand, the Telecommunication Act prohibits compensation for the use of ROW that is competitively non-neutral and discriminatory. As a general matter, a fee is nondiscriminatory if telecommunications providers using the ROW in similar ways, under similar circumstances, pay similar fees. Companies differ. Not all telecommunications providers use the ROW in the same way to access customers. For example, local telephone companies providing service via their own wired facilities make extensive use of ROW to access customers. A wireline company may have hundreds or thousands of miles of fiber in a ROW. Wireless companies, however, do not occupy space in the ROW in the same way. A wireless company may not own any facilities or equipment in the ROW, or place only a minimal amount of facilities in the ROW. One could reasonably distinguish among those providers for the purpose of arriving at compensation for access to the ROW.

In addition, economic conditions change over time. All else equal, providers that enter the market at different points in time face different economic conditions. In a competitive market, such providers would likely face different costs for the resources they use. Likewise, it would not necessarily be either discriminatory or non-neutral for the details of the compensation packages between each of such providers and the City to differ.

While in theory one might posit a single fair and reasonable price for a good, in practice it does not happen. There is a range of prices that a seller could charge without exceeding levels that would be considered fair and reasonable. As I understand, some providers in Portland provide some of their compensation in the form of in-kind payments. As I describe in Section IV, such arrangements are not unusual. In some cases, a municipality may even choose to lease ROW space at no charge in order to obtain other perceived benefits—even when charging something would be fair and reasonable.

C. Calculating Fair Market Value Using Comparable Transactions

Unlike residential or commercial real estate, any given market for a municipal ROW has relatively few transactions and private companies have strong (and reasonable) incentives not to publish the results of their transactions involving ROW. Given these constraints, the study of comparable transactions has become an established practice for valuing ROW.[9]

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[9] *See*, for example, Fitzgerald, Shawna. 2005. *Review of Fiber Optic Right of Way Pricing*. Prepared for the City of Portland. August 31. Page 6; National Oceanic and Atmospheric Administration (NOAA). 2002. *Final Report: Fair Market Value Analysis For A Fiber Optic Cable Permit in National Marine Sanctuaries*. NOAA, National Ocean Service, National Marine Sanctuary Program. August; U.S. Department of Justice. 2001. *Uniform*

The degree of similarity between the comparable transactions and the ROW at issue helps specify the high and low measures of fair market value.[10] Fitzgerald describes some of the factors to consider when setting rates to access a municipal ROW.

> "Several distinctions can be made for the wide range for [ROW] rates, including the level of services and security provided, location, and the date the [ROW] policy or contract was signed. Also, the ability of government organizations to set fees, unfettered by political interference, is another important factor in [ROW] rents. However, the issue that seems to have the greatest impact is the level of sophistication and information held by both buyers and sellers."[11]

Fitzgerald's last point on the amount of information available to the two interested parties, speaks to the importance of considering relevant information held by the municipality and by the telecommunications firm or firms. Specific to the case at hand, the City lists the details of its ROW fees on its web site. QCC and TWT can access this information. Knowing what QCC and TWT pay to access other municipal ROW would provide information relevant to the deliberations of the fair-market value to access the City's ROW. The existing ROW agreements between the City and QCC and TWT also provide relevant information.

IV. The City's ROW Fees Make Economic Sense

As I understand, TWT has access to ubiquitous ROW, i.e., ROW throughout the City, and the City charges TWT 5 percent of gross revenues plus one or two ducts for the City's use. As I understand further, QCC has access to only a limited section of the City's ROW, and the City charges QCC approximately $3 per linear foot plus some ducts for the City's use. From an economic perspective, based on the information available, I find neither type of fee unfair, unreasonable, discriminatory, or competitively non-neutral. In this section I describe several methods for calculating the value of ROW, and then I describe my evaluation of the City's ROW fees.

A. A Number of Acceptable Methods Exist for Calculating the Market Value of ROW.

The appraisal literature describes a number of methods for calculating the market value of ROW. These methods include calculating market value based on similar transactions, which appraisers call "comparables." I describe four methods.[12]

Appraisal Standards for Federal Land Acquisitions. http://www.usdoj.gov/enrd/land-ack/yb2001.pdf accessed August 29, 2005.

[10] Ring, A. 1970. *The Valuation of Real Estate*. Prentice Hall. In, Quan, D. and J. Quigley. 1989. "Inferring an Investment Return Series for Real Estate from Observations on Sales." *Journal of the American Real Estate and Urban Economics Association*, 17(2); and U.S. Department of Justice. 2001. Cited previously.
[11] Fitzgerald, Shawna. 2005. Cited previously. Page 29.

[12] NOAA. 2002. Cited previously. Pages 7-13.

1. Land-based appraisals: Analysts calculate the value of a ROW based on the value of land adjacent to the ROW. This is sometimes referred to as the "across-the-fence" (ATF) method. A variation on the ATF method acknowledges that because a ROW provides a continuous corridor, a ROW has a higher value than the disparate, unassembled adjacent parcels. This corridor value can exceed the ATF value by a factor of six or more.

2. The willing-buyer-and-willing-seller method: Analysts seek to replicate market negotiations over the value of the ROW. The seller considers his or her costs, including the value he or she could earn from other uses of the land. The buyer considers the income-generating potential of the ROW and the costs of alternative routes.

3. Income-based methods of valuation: Analysts take as given that a variety of assets contribute to a firm's income or value. A ROW may be one of many income-generating assets from which a firm would expect to earn a reasonable return. The analysts base the market value of the ROW on the return the asset generates for the firm.

4. The comparable-transactions method: Analysts base the market value of ROW on the sales of similar ROW. Information on most ROW transactions between private entities remains confidential. More publicly available information exists on ROW agreements between municipalities and private firms that want access to municipal ROW.

As I describe in subsections B, C, and D, the City's ROW fees are consistent with generally accepted valuation methods, and they make economic sense.

B. A ROW Fee Based on a Percentage of Gross Revenues Is an Accepted Method of Estimating a Fair Market Price for Using ROW

Imposing a fee that is a percent of gross revenues is a reasonable way to price the ROW. Furthermore, given the information available, it meets the generally accepted standard in economics for efficient compensation in exchange for goods or services, namely, a price that reflects the value of the good or service to the buyers and sellers. ROW, like other real-estate assets, convey value to its users. TWT's use of the City's ROW conveys or adds value to TWT.

This method is straightforward and has low transaction costs. That is, both the City and TWT can resolve the amount owed with minimal accounting and auditing. In contrast, calculating a per-foot fee for a provider with access throughout the City would be time-consuming, costly, and generally inefficient. Moreover, a percentage-based fee is convenient because the fee directly tracks the amount of business passing through ROW facilities. Therefore, the fee reflects a reasonable and up-to-date measure of the value TWT receives from using the City's ROW.

The City's annual ROW fee charged to TWT is 5 percent of gross revenues. A host of similar transactions demonstrates that the City's fee is within a range of reasonable fees. For example, I understand that there are approximately eleven other local-exchange carriers that operate in the City, each of which has an agreement with the City that includes the 5-percent fee that TWT challenges.[13] Moreover, other occupants with ubiquitous access to the City's ROW generally pay 5 percent of gross revenues. Specifically, Northwest Natural, Pacific Power and Light, and Portland General Electric, which also occupy the City's ROW, each pays a 5-percent fee to the City.[14]

In addition, Qwest and other telecommunications carriers pay a 5-percent franchise fee in Fargo, North Dakota;[15] Henderson, Nevada;[16] and Wichita, Kansas.[17] In Salt Lake City, Utah, Qwest pays a 2-percent franchise fee and a 4-percent utility tax.[18] It is not by chance that the City charges a percentage rate in line with percentage rates charged elsewhere. The similarity in rates reflects similarities across urban areas. Such similarities emerge in the field of urban economics, which involves the study of common economic forces affecting urban economies. In that spirit, considering the fees paid by carriers to other municipalities provides meaningful information that can be used to judge the reasonableness of fees paid by carriers to the City.

A 5-percent fee seems easily in line with the percentage rents paid in the retail industry. For example, operators of movie theatres pay an average of between 8 percent and 12 percent of gross receipts. Restaurants pay, on average, between 5 percent and 7 percent. These amounts are usually on top of a base rent, which TWT does not have to pay to the City.[19]

Based on the foregoing information and on my professional knowledge of demand, supply and markets, I conclude that the 5-percent fee imposed in the City's franchise agreement with TWT is neither unfair nor unreasonable compensation for placing facilities in the City's ROW.

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[13] According to information posted on the City's Cable Communications and Franchise Management website (http://www.portlandonline.com/cable/index.cfm?c=33150), accessed August 17, 2005, the other local exchange carriers are AboveNet, All-Phase Utility, Electric Lightwave, Inc., Enron Broadband Services, Integrated Regional Network Enterprise, Level 3, MCI Metro, McLeod USA, ONFiber, TCG Oregon, and XO Communications.

[14] The utilities are listed on the City's Cable Communications and Franchise Management website, cited previously. According to Chapter 7.14 of the Portland City Code, electrical and gas utilities pay 5 percent of gross revenues and other utilities pay the City 5 to 7.5 percent of gross revenues.

[15] Fargo City Code. 2000. Article 24-03: Grant of Access and Use of Public Rights-of-Way. Page 24-85.

[16] Henderson Municipal Code. Section 4.05.020(B)(1)(a). http://municipalcodes.lexisnexis.com/codes/henderson/_DATA/TITLE04/Chapter_4_05_BUSINESS_LICENSE_FEE_/4_05_020_Public_utility_licens.html accessed August 30, 2005.

[17] Wichita City Code. Section 3.93.004: Franchise and License Fees. Subsection 4.2: Franchise Fees. http://www.wichitagov.org/CityCode/Default.htm?code=3980 accessed August 30, 2005.

[18] Torrence, Rachel. Deposition Transcript. November 25, 2002. In the matter of Qwest Corporation v. City of Globe, Arizona. CIV 01-2500. Page 31.

[19] Senn, Mark A. 2000. *Commercial Real Estate Leases: Preparation, Negotiation, and Forms*, 3rd Edition. Gaithersburg, MD: Aspen Law and Business. Section 6.06(C).

C. A ROW Fee Based on Feet of Installed Conduit Is an Accepted Method of Estimating a Fair Market Price for Using ROW

Calculating ROW fees on a per-linear-foot basis is another accepted method of estimating the market value for using the ROW. Such a method is especially useful where providers occupy limited portions of the ROW. In a survey of different fee structures used by municipalities to charge for ROW use, Bucaria and Kuhs found that charging based on linear feet of ROW is a fee structure commonly used by municipalities.

> "The fact that there are established telecommunications corridor right-of-way rental markets allows some direct rental rate comparisons to be made, often in terms of dollars paid annually per lineal foot of right of way, conduit, or cable."[20]

> "Linear measure for both sales and rental comparison purposes are comparison approach methods. They are well accepted by both industry and property owner representatives. Linear measure data is relatively plentiful. Accordingly, use of this method of market comparison is valid and useful in telecommunications corridor valuation situations."[21]

Bucaria and Kuhs also note that the rate per linear foot may vary depending on the number of lines of fibers installed and the diameter of the conduit.

Calculating the market value of ROW access using a per-foot fee for providers occupying limited and distinct routes in the ROW has advantages in that it is straightforward and has low transaction costs, facts that seem reasonable for a City to consider in establishing a ROW fee. Because QCC needs access to only a limited stretch of the City's ROW rather than access to all of the City's ROW, both the City and QCC can resolve the amount owed with minimal accounting and auditing.

The City's annual ROW fee to QCC is approximately $3.00 per linear foot. I understand that there are approximately ten other point-to-point carriers that operate in the City, each of which also has an agreement that includes a $2-$3 fee per linear foot with an annual increase based on the consumer price index.[22, 23]

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[20] Bucaria, Charles and Robert Juhs. 2002. "Fiber Optic Communication Corridor Right-of-Way Valuation Methodology." *The Appraisal Journal.* April. Page 138.

[21] Bucaria, Charles and Robert Juhs. 2002. Cited previously. Page 143.

[22] As I understand, the City's per-foot fee is nearly the same across all carriers, and it is based on a rate of $2 per linear foot established in approximately 1990 with subsequent increases tied to increases in the consumer price index. As I understand further, in setting its rate the City considered the value of its ROW and examined rates in cities in the Northwest and in other areas of the U.S. Slight differences in the fees listed in the agreements are the result of the differences in the years in which each agreement was signed. In addition, there may be differences due to the time between the date that the agreements were signed and the date that the agreements became effective. Soloos, David, Assistant Director, Office of Cable Communications and Franchise Management, City of Portland. Personal Interview. August 30, 2005.

[23] According to information posted on the City's Cable Communications and Franchise Management website (http://www.portlandonline.com/cable/index.cfm?c=33150), accessed August 17, 2005, the other point to point

In addition, information on comparable transactions from other areas yields a range of fees from approximately $1.80 to $5.00 per linear foot. As I stated in subsection B, when calculating a fee in one area, considering the fees charged in other areas is a valid approach.

Macon, Georgia charges $4.50 per foot; Savannah, Georgia and Atlanta, Georgia charge $5.00 per foot; Gainesville, Florida charges $4.00 per foot;[24] Huntsville, Alabama charges Level 3 $4.50 per foot for the first five years, increasing $1.50 per foot the next five years, and increasing an additional $1.50 per foot the next five years;[25] Burbank, California charges Level 3 $3.99 per foot;[26] Glendale, California charges Level 3 $1.80 per foot;[27] Rialto, California charges Level 3 $2.00 per foot;[28] and San Bernardino County, California charges Williams Communications $3.00 per foot.

Also, the Fitzgerald Report describes a number of contracts between public entities and a variety of parties for occupying space in the ROW or in other similar resources. Per-linear-foot charges are common when entities want to occupy a finite number of feet. The annual per-linear-foot charges range from less than $1.00 to over $100 per foot, where the higher charges are either for the placement of multiple ducts or fibers or for occupying space in resources such as elevated highways or the New York/New Jersey Lincoln Tunnel.[29]

Based on the information that is available to me at this time and on my professional knowledge of supply, demand and markets, I conclude that charging for ROW use based on a fee per linear foot of ROW occupied is an acceptable method of calculating the fee for using the City's ROW, especially in cases such as this where the telecommunications firm occupies a limited portion of ROW.[30] Furthermore, the list of fees above indicates that the

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carriers are Tyco Networks (U.S.), Inc. 360 Networks, AT&T Long Distance, Broadwing Communications, FTV Communications, PT Cable, Sprint Communications, WCI Cable, WilTel, WorldCom Network Services, Inc.

[24] We obtained information on comparator fees in Georgia and Florida from a personal interview staff in the City of Huntsville, Alabama. We acquired information on the comparator fees in California from an appraisal by Jones, Roach & Caringella, June 12, 2003 and other documents where noted. I have excluded the City of Escondido, which was included in the appraisal, as a comparator because it has no annual fee. This suggests either that Escondido's ROW is not a scarce resource or that through ignorance or non-market constraints, Escondido has offered its ROW free of charge. Any of these conditions disqualifies Escondido as a relevant comparator for the dispute at hand.

[25] An Ordinance Respecting the Use of the Public Rights-of-Way in the City of Huntsville, Alabama by Level 3 Communications, LLC. Ordinance No. 00-819. October 12, 2000. Section 8.1.

[26] Encroachment Permit Agreement between Level 3 Communications, LLC and the City of Burbank. October 12, 2000.

[27] Telephone Corporation Encroachment Permit Agreement between Level 3 Communications, LLC and the City of Glendale.

[28] Telecommunications Encroachment Permit Agreement between Level 3 Communications, LLC and the City of Rialto. October 16, 2000.

[29] Fitzgerald, Shawna. 2005. Cited previously. Page 11.

[30] Edsall, Gary, of the City of Glendale. Personal Interview. July 17, 2003; and Goulding, Diane, of the City of Burbank. Personal Interview. July 17, 2003.

City's fee falls in the relevant range of comparable fees. Therefore, I conclude that the fee of approximately $3.00 per linear foot imposed in the City's franchise agreement with QCC is not unfair, unreasonable, discriminatory or competitively non-neutral.

D. In-Kind Compensation Is Acceptable for the Use of ROW

The franchise agreements also include in-kind compensation as part of the fee for using the City's ROW. That is, in addition to a monetary payment, both TWT and QCC must provide ducts for the City's use. In an economic sense, the monetary payments and the in-kind payments together comprise the price of using the ROW. From the information we have examined, such complementary transactions within agreements occur frequently. I also understand that they aren't unusual in negotiated agreements between telecommunications companies and municipalities. The ROW agreement between the City of Huntsville, Alabama and Level 3, for example, provides fiber and manholes for the City of Huntsville's use.[31] The Fitzgerald Report describes a number of contracts that incorporate in-kind payments as part of the compensation for use of ROW and other similar resources.[32]

If the City required additional monetary compensation instead of in-kind payments, it could purchase its own duct. It is likely, however, that the in-kind arrangement is comparatively more beneficial to both QCC and TWT. That is, the providers may be able to provide the City with ducts at a lower cost than the monetary fee the City would otherwise require. I conclude that the in-kind duct requirement is part of a reasonable compensation package and is neither discriminatory nor competitively non-neutral.

E. The City's Fees Are Neither Discriminatory nor Non-Neutral

I do not find that the City's different compensation packages for different types of providers amount to discrimination or bias. As I have described, TWT and QCC use the ROW differently. Even among providers that use the ROW in similar ways, differences from agreement to agreement are to be expected. That is, even within the same market, competitors generally do not face identical economic conditions. Some of the differences in economic conditions stem from differences among the competitors themselves. Other differences stem from the point in time that transactions occur. Based on my review of the fees at issue in this case, I find that providers that use the ROW in similar ways are charged similar fees. I do not find evidence that the fees are discriminatory or non-neutral or that the fees tend to favor or disfavor any competitor over any other.

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[31] An Ordinance Respecting the Use of the Public Rights-of-Way in the City of Huntsville, Alabama by Level 3 Communications, LLC. Ordinance No. 00-819. October 12, 2000. Section 8.7.

[32] Fitzgerald, Shawna. 2005. Cited previously. Attachment A. Fitzgerald lists a number of agreements that include the provision of fiber or duct in New York State, Massachusetts, Wyoming, Kansas, Maryland, New Jersey, Rhode Island, and Wisconsin.

V. OTHER ISSUES

A. Competitive Differences

The City's Integrated Regional Network Enterprise (IRNE) provides dial-tone (voice) and data-transmission services to City bureaus, and data-transmission services to jurisdictions in the area (e.g., the Port of Portland, Portland Public Schools, and Multnomah County).[33] As I understand, IRNE does not provide any telecommunications services to residences or private businesses.[34]

The Plaintiffs claim that the City, through IRNE, competes unfairly with QCC and TWT. The Plaintiffs' complaint states, in part,

> "[A]s a condition to using the public ROWs, the City has improperly required the Carriers to provide the City with free or below cost use of conduit, fiber and related equipment and facilities. The City in turn is using these same valuable network assets to operate its own telecommunications company in competition with the Carriers — acting through a City entity known as the Integrated Regional Network Enterprise ('IRNE')."
>
> "[T]he municipality [City of Portland] is using its control over access to ROWs to unfairly advantage *itself* in its role as a telecommunications provider."[35] [emphasis in original]

In economics, a competitive advantage, as alleged by the Plaintiffs, does not constitute unfair competition. In fact, many firms, many competitors in the same market, have different competitive strengths and weaknesses. A business is made up of a composite of attributes that affect its performance in a market including: access to capital, raw materials or other inputs; production functions or manufacturing processes; the quality of its labor force; and customer relations. All competing firms in a market have their own unique combination of attributes. Some firms may have better, i.e., less expensive, access to capital. Others may have a better-trained work force. Firms survive by maximizing their strengths and minimizing or mitigating their weaknesses.

The economic literature describes these inherent differences among firms and how they can affect a firm's costs and profits.

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[33] City of Portland's Concise Statement of Material Facts Not In Dispute. April 2005. In the matter of Time Warner Telecom of Oregon, LLC and Qwest Communications Corporation v. the City of Portland. Page 2, paragraph 8.

[34] Defendant's Response To Plaintiffs' First Set of Written Discovery. January 5, 2005. In the matter of Time Warner Telecom of Oregon, LLC and Qwest Communications Corporation v. the City of Portland. Response to Interrogatory No. 17, pages 14-15.

[35] Complaint for Declaratory Judgment (First). Cited previously. Pages 2-3.

"[T]he rate of profit [among firms] may vary ... from unit to unit according to the differences in their capital-structure, particularly the relationship between the 'owned' and 'borrowed' capital ..."[36]

"There are at least four major causes of lower costs:

- A firm may be more efficient than its rivals. For example, it may have better management or better technology that allows it to produce at lower costs. Such a technological advantage may be protected by a patent.
- An early entrant to a market may have lower costs from having learned by experience how to produce more efficiently.
- An early entrant may have had time to grow large optimally ... so as to benefit from economies of scale. By spreading fixed costs over more units of output, it may have lower average costs of production than a new entrant could instantaneously achieve.
- The government may favor the original firm. The U.S. Postal Service does not pay taxes or highway user fees, which reduces its cost relative to that of competing package delivery services."[37]

"What factors could lead to a gap between the average costs of established firms and potential entrants? Firms already in the industry may control a crucial input, may be able to borrow investment funds at lower interest rates than potential entrants, or they may have access to superior production technologies, perhaps protected by patents. They may have built plants in the most desirable locations, forcing new firms to ship raw materials or the final product greater distances. Also entrants may have to pay more for scarce inputs, such as raw materials, managerial talent, or research personnel."[38]

"The first mover advantage within an industry may make it possible to build brand loyalty, profit from early experience,

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[36] Mehta, M.M. 1950. "Measurement of Industrial Efficiency." *The Economic Journal*, 60(240): 827-831. Page 828.

[37] Carlton, Dennis W. and Jeffrey M. Perloff. 1999. *Modern Industrial Organization*, 3rd Edition. Reading, MA: Addison-Wesley. Pages 110-111.

[38] Waldman, D. and Jensen, J. 1998. *Industrial Organization: Theory and Practice*. Reading, MA: Addison-Wesley. Page 110.

> gain control over scarce assets and create switching costs that bind consumers to the company."[39]

In the case at hand, competitive differences arise in part because of the contrasting objective functions between the Plaintiffs, profit-maximizing entities, and the City, a municipal entity that serves the interests of all Portlanders. As I understand, IRNE, as a municipal entity, operates at a competitive disadvantage to the Plaintiffs in a number of areas including:

- Municipal planning, decisionmaking, managing data, allocating funds, etc., take place in an open, public, and time-consuming manner. Private firms operate in relative secrecy and as a result typically can react more quickly to changing conditions.

- Private firms have access to financing options not available to municipal entities, e.g., stock sales.

- Private firms may provide a wide-range of telecommunications services. IRNE provides only dial-tone service to City bureaus and data-transmission services to City bureaus and to a limited number of other jurisdictions in the area.

- Private firms can increase sales through advertising and marketing. IRNE does neither. In fact, as I understand, IRNE takes a passive approach to providing its services. For example, IRNE has no influence over the number of phone lines used by the City's accounting department. The accounting department makes that determination without input from IRNE.[40]

- IRNE does not provide voice or data service to any residence or business.[41]

- The prices for IRNE's services to City bureaus cannot increase beyond the rate of inflation.[42] Individual private firms do not face such a constraint on their pricing decisions.

Market participants bring with them their own, unique mix of competitive strengths and weaknesses. The local Portland market for telecommunications services is no different. The Plaintiffs emphasize one of the City's advantages—it controls the ROW. This advantage, however, does not constitute a barrier to entry or some other form of antitrust behavior. The Plaintiffs ignore the City's competitive disadvantages, some of which I describe above.

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[39] Jenssen, Jan Inge. 2003. "Innovation, Capabilities and Competitive Advantages in Norwegian Shipping." *Maritime Policy and Management*, 30(2): 93-106. Page 95.

[40] Gray, Mark, Manager of Communications Operations and Engineering for the City of Portland. Personal Interview. August, 12, 2005.

[41] Defendant's Response to Plaintiffs' First Set of Written Discovery. Cited previously. Response to Interrogatory No. 17, pages 14-15.

[42] Smith, Ralph, of the City of Portland's Office of Finance and Management. Personal Interview. August 5, 2005.

The Plaintiffs' claim regarding the City's competitive advantage ignores the fundamental economic principles that drive competition. Competition does not thrive and grow by *limiting* one party's competitive advantage. Rather than lowering the bar for all sellers of goods or services in a market, competition encourages advantages that benefit the consumer. Such is the case here. As I describe in the last subsection of this report, the City's control of its ROW and the services IRNE provides benefit consumer by providing comparable or superior services at lower rates.

B. QCC and TWT Did Not Build IRNE

The Plaintiffs allege that the City built IRNE using the in-kind payments it received from QCC, TWT, and other telecommunications firms.

> "[T]he City has and is using the valuable network assets it extorted from the Carriers [QCC and TWT] and other service providers to operate its own competing telecommunications company."[43]

> "In addition to providing conduit and fiber, the City has used cash received from franchisees to construct the IRNE. ... As a result, carriers have been forced to build their own competitor."[44]

In previous subsections of this report, I explain the economic rationale for why the in-kind payments made by QCC and TWT to access the City's ROW—a scarce and valuable resource—are economically fair and reasonable. In my research and teaching on the economics of crime, I have never encountered professional economics literature—in either journals or text books—that has equated fair and reasonable pricing with extorting property, funds, patronage or excessive fees.

Based on the information available to us at this time, I find no support for the claim that the Plaintiffs were "forced to build their own competitor." A small percentage of the conduit used by IRNE came from the in-kind component of payments by some franchisees—but the Plaintiffs were not among them, i.e., they provided none of this conduit.[45] Furthermore, telecommunications firms provided none of IRNE's fiber. To the extent it is relevant, the City provided 89 percent of the conduit (and aerial runs) that constitutes IRNE. The City describes the sources of the conduit that IRNE uses.

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[43] Plaintiff Qwest Communications Corporation's Response to City of Portland's First Set of Interrogatories (Nos. 1-15). January 2005. In the matter of Time Warner Telecom of Oregon, LLC and Qwest Communications Corporation v. the City of Portland. Response to Interrogatory No. 2, page 6.

[44] Plaintiffs' Response to Defendant's Motion for Partial Summary Judgment and Motion for Joinder. May 6, 2005. In the matter of Time Warner Telecom of Oregon, LLC and Qwest Communications Corporation v. the City of Portland. Pages 6-7.

[45] Gray, Mark, Manager of Communications Operations and Engineering for the City of Portland. Personal Interview. August, 12, 2005.

> "The physical facilities used by IRNE were contributed by several different sources. Of the segments of conduit and aerial runs connecting the various nodes of IRNE, by segment count approximately 43% were build by the City itself, 38% were built by other public entities (especially the State of Oregon and Tri-Met), 5% were built by the City in cooperation with other public entities, and 3% were constructed by the City in cooperation with private telecommunications providers. Finally, about 11% of the IRNE conduit infrastructure was dedicated to City use by "in-kind" contributions of various City telecommunications franchisees. The City uses no conduit contributed by plaintiffs Time Warner or Qwest to operate IRNE."[46]

Conduit, of course, is only a fraction of the inputs to the construction, operation and maintenance of IRNE. The inputs, in the conventional economic categories of capital, labor, and technology (i.e., knowledge and its applications), include fiber, switches and other equipment as well as labor ranging from the technical and administrative workers to the construction, operation and maintenance workers. Not incidentally, the City Council authorized the sale of $11 million in bonds to build IRNE and make it operational.[47] As I understand, the Plaintiffs did not build IRNE or any part thereof. They contributed none of the inputs—the resources—that constitute IRNE.

C. The Conduit Paid In-Kind Provides the City with No Measurable Competitive Advantage

The Plaintiffs claim,

> "As a result [of in-kind payments of conduit], the City obtains valuable telecommunications network facilities on terms far below their actual cost, while artificially inflating the costs of other service providers that compete with IRNE. Thus, in those markets the City chooses to enter, private telecommunications carriers are unable to provide services because of the City's artificially low prices."[48]

The Plaintiffs' claim, once again, is wrong. The in-kind payments made by the Plaintiffs, as I state above in Section IV.D, represent a portion of the fair and reasonable compensation to access the City's ROW. The terms of the exchange between telecommunications providers and the City reflect market rates to access the City's ROW and do not amount to either a below-cost transaction for conduit or artificially inflating costs to the providers.

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[46] City's Memorandum in Support of Motion for Partial Summary Judgment. Cited previously. Page 6.

[47] City's Memorandum in Support of Motion for Partial Summary Judgment. Cited previously. Page 5.

[48] Plaintiff Time Warner Telecom of Oregon, LLC's Response to City of Portland's First Set of Interrogatories (Nos. 1-15). January 14, 2005. In the matter of Time Warner Telecom of Oregon, LLC and Qwest Communications Corporation v. the City of Portland. Response to Interrogatory No. 2, page 5.

To put the Plaintiffs' claim in perspective, it helps to consider the actual costs involved. First, IRNE's production function—to use the jargon of economics—involves construction, operation and maintenance. Second, focusing for the moment on construction alone, an analysis conducted by the City's consulting telecommunications engineer shows that the cost of labor and materials to install a 2-inch conduit represents less than 5 percent of the total cost of excavating a trench, installing conduit, and filling in and paving over the trench.[49] As I understand, once a trench is opened, installing one, two, or more, 2-inch conduits represents a small marginal increase in the overall cost of trenching. Third, the conduit provided by other telecommunications companies—none of which is either of the Plaintiffs'—constitutes 11 percent of the total amount of conduit used by IRNE.[50] Fourth, it follows then that telecommunications companies provided, as part of their fair and reasonable payments for the ROW, 0.55 percent (5% of 11% = 0.55%) of the excavation-installation-related construction specific to IRNE's conduit. Fifth and finally, the labor and materials cost specific to conduit accounts for only a portion of the total cost of IRNE; the total cost also includes other construction costs, and the costs associated with operation and maintenance.

The in-kind payments from telecommunications firms amount to a miniscule proportion of the total value of IRNE and confer no measurable competitive advantage to the City. I repeat, for emphasis and clarity, that the Plaintiffs provided none of the conduit paid in-kind that IRNE uses.

I find no support for the claim that private telecommunications firms have not been able to provide services in the dial-tone (voice) and data-transmission market in the Portland area. In fact, as I understand, QCC still earns approximately $50,000 per year on voice service (telephone) and $50,000 per year on data-transmission services from the City and other IRNE users.[51] QCC also has a pilot project with Portland Public Schools to provide voice over IP (Internet Protocol) services,[52] and the Port of Portland leases two telecommunication lines from Qwest.[53] For its part, IRNE earns approximately $83,000 per year on its data-transmission services provided to other jurisdictions.[54] IRNE, however, provides no telecommunications services to any business or residence.

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[49] Analysis conducted by Erik Orton, Project Manager, Sparling: Orton, Erik. *Incremental Cost Analysis*. Received in an email from Terry Thatcher to Ed MacMullan. August 25, 2005.

[50] Gray, Mark. Declaration. April 2005. In the matter of Time Warner Telecom of Oregon, LLC and Qwest Communications Corporation v. the City of Portland. Page 5, paragraph 16.

[51] Smith, Ralph, of the City of Portland's Office of Finance and Management. Personal Interview. August 5, 2005.

[52] Holstun, S. 2005. Interview with Scott Robinson, Chief Technology Officer for the Portland Public Schools. August 3.

[53] Holstun, S. 2005. Interview with Wayne Splawn, Communication Services Manager for the Port of Portland. August 9.

[54] Gray, Mark. Declaration. Cited previously. Page 4, paragraph 14.

D. Sharing Resources Does Not Constitute Anticompetitive Behavior

The Plaintiffs allege that the intergovernmental agreements (IGA) between the City and each of two other agencies, the Oregon Department of Transportation (ODOT) and Tri-Met, to share fiber and conduit amounts to anticompetitive behavior.

> "[I]t appears ... that the IGA [intergovernmental agreements] ordinances with ODOT, PDOT, and Tri-Met allow the City to construct its [IRNE] network and use those network assets for minimal cost. As a cumulative result of these ordinances telecommunication providers are effectively prohibited from providing telecommunication services in the government and educational market."[55]

> "IRNE also receives conduit through IGAs with other government entities that is not available to other competitors."[56]

The Plaintiffs' claim, once again, is wrong. Sharing resources does not constitute anticompetitive behavior on the part of the City or the other municipal entities. In fact, economic and business literature describes examples of private, profit-maximizing firms such as the Plaintiffs, sharing resources. Local examples include telecommunications firms in the Portland market—competitors in some cases—sharing the cost of constructing a trench through the heart of downtown Portland.[57] Also, TWT, a Plaintiff in this litigation, shares ROW access and construction costs in ways similar to the City's alleged anticompetitive behavior.[58]

Private entities, including telecommunications firms, share resources for a variety of reasons. The economics and business literature describes this type of cooperation as strategic alliances.

> "Companies, both big and small, are teaming up more today than ever before to enhance their competitiveness in the marketplace and keep pace with the rapid changes of technological innovation."

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[55] Plaintiff Qwest Communications Corporation's Second Supplemental Response to City of Portland's First Set of Interrogatories (Nos. 1, 2 and 4). March 16, 2005. In the matter of Time Warner Telecom of Oregon, LLC and Qwest Communications Corporation v. the City of Portland. Supplemental Response to Interrogatory No. 2, pages 7-8.

[56] Plaintiffs' Response to Defendant's Motion for Partial Summary Judgment and Motion for Joinder. May 6, 2005. In the matter of Time Warner Telecom of Oregon, LLC and Qwest Communications Corporation v. the City of Portland. Page 13.

[57] Soloos, David, Assistant Director, Office of Cable Communications and Franchise Management, City of Portland. Personal Interview. August 24, 2005.

[58] Time Warner Telecom Inc. 2004. Form 10-Q. U.S. Securities and Exchange Commission, Washington, D.C. August 9. http://www.sec.gov/Archives/edgar/data/1057758/000119312504135846/d10q.htm#tx86290_6 accessed August 25, 2005. Page 26.

> "A strategic alliance is an arrangement between two companies that combine resources to gain additional business ... It involves two companies that pool together expertise and resources to enter new markets, share financial risks and get products and services to market faster."[59]
>
> "Although firms gain advantages from possessing idiosyncratic resources ... authors in several research traditions argue that interfirm alliances provide a means of pooling resources held by different firms in order to exploit new business opportunities and to increase the efficiency of existing business activities."
>
> "The alliances include firms operating in the telecom-electronics, auto, aerospace, and other sectors."[60]
>
> "[W]ith the exorbitant cost inherent in deploying a new mobile telecommunication network technology, it does no longer appear to be a safe bet for investors that 3rd generation technologies will provide sufficient return on investment. … [W]e identify the possibility to share risks and costs among several participating parties as a viable strategy for telecommunication operators."[61]
>
> "A ... method which applies only to reciprocal compensation, is called bill and keep or sender keeps all. The underlying theory is that the number of calls exchanged between two networks should be about equal in both directions, so charging is unnecessary."[62]

As I understand, eight telecommunications firms[63] plus PGE shared the cost of constructing a trench in the City ROW through the heart of downtown Portland.[64] The trench, known as the "Level3 trench," provides a local example of telecommunications firms pooling resources

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[59] Isidro, Isabel M. "Small Businesses and the Power of Strategic Alliances." *International Cyber Business Services*. http://www.ecomhelp.com/KB/joint_venture/kb_strategic-alliances.htm accessed August 8, 2005.

[60] Mitchell, Will, Pierre Dussauge and Bernard Garrette. 2002. "Alliances With Competitors: How to Combine and Protect Key Resources." *Creativity and Innovation Management*, 11(3): 203-223. Page 204.

[61] Ericsson, Nilo Casimiro, et al. *Strategies for Pooling Resources to Build Future Telecommunication Networks*. www.itm.mh.se/summerschool/Reports/FinalReportTrack2.pdf accessed August 8, 2005. Page 1.

[62] Jamison, Mark A. (no date). *Incumbent and Entrant Incentives with Network Interconnections: The Case of US Telecommunications*. Working Paper. Page 8.

[63] Level 3, MFN (now known as AboveNet), McLeod, XO, Allphase, PGB (now known as OnFiber), Williams (now known as WilTel), and Adelphia.

[64] Spreadsheet provided by Alan Williams of the Fluor Corporation: Williams, Alan. *Joint Partner Matrix*. Received in an email from Terry Thatcher to Ed MacMullan. August 26, 2005.

in ways that benefit each of them individually. In this case the City, and its residents and businesses, also benefit from a single construction activity, rather than multiple construction projects with associated costs imposed on commercial activity, vehicular traffic and pedestrians.[65]

In another local example of a telecommunications firm benefiting by sharing resources, Electric Lightwave Inc. (ELI) and Northwest Natural Gas Co. (NWNG) developed an agreement to their mutual benefit. ELI paid NWNG a one-time fee of between $9 and $12 per linear foot to install fiber optic cable in abandoned or unused gas pipelines in Portland.[66] As I understand, this fee is much less than what ELI would have paid to design, permit, and construct a trench through the City's ROW. NWNG benefits by earning revenue on abandoned or unused pipeline.

Plaintiff TWT alleges in part that the IGA between the City and other municipal entities to share ROW, conduit and fiber amount to anticompetitive behavior. I note, however, that TWT has similar agreements to share ROW access, fiber capacity and construction costs. TWT describes these agreements in their Form 10-Q filed with the U.S. Securities and Exchange Commission.

> "We [TWT] benefit from our relationship with Time Warner Cable, ... both through access to local rights-of-way and construction cost sharing. We have similar arrangements with Bright House Networks, LLC ... . We have constructed 23 of our 44 metropolitan networks substantially through the use of fiber capacity licensed from these affiliates."[67]

I have seen no information that would lead me to conclude that the City engages in anticompetitive behavior by sharing resources through IGA with other municipal entities.

E. The City Holds IRNE to the Same Standards as Other Telecommunications Firms

The Plaintiffs claim that the City holds IRNE to different standards than other telecommunications firms,

> "The City does not impose the same ROW terms and conditions on its affiliate IRNE that it does on other telecommunications providers. IRNE is not required to compensate the general public for IRNE's share of the cost of managing the City's

[65] Soloos, David, Assistant Director , Office of Cable Communications and Franchise Management, City of Portland. Personal Interview. August 24, 2005.

[66] Fiber Optic Cable Construction and Gas Pipeline Use Agreement Between Northwest Natural Gas Company and Electric Lightwave, Inc. April 29, 1991.

[67] Time Warner Telecom Inc. Form 10-Q. Cited previously. Page 26.

> ROWs or bear the same burdens associated with ROW use that the City has imposed on IRNE's competitors."[68]

As I understand, IRNE obtained a franchise to use the City's ROW and pays the City 5 percent of gross revenues[69] on services provided under Intergovernmental Agreements (IGAs) with other jurisdictions, e.g., Port of Portland, Portland Public Schools, etc.[70]

I also understand that IRNE provides services in-kind to the City in at least two ways: providing engineering and planning services to other City bureaus, and swapping fiber with other jurisdictions. IRNE provides in-kind services to the City when IRNE technicians work with staff from other City bureaus on projects that involve IRNE resources. For example, the City's Bureau of Environmental Services (BES) connects their pump stations using fiber-optic cable. BES pays for the conduit and fiber, while IRNE technicians provide engineering and planning services.[71]

IRNE also provides in-kind services to the City by swapping fiber with other jurisdictions. Under this arrangement, City bureaus have access to fiber owned by Tri-Met or the Oregon Department of Transportation. These jurisdictions, in turn, have access to IRNE's fiber.

F. By Matching or Underpricing the Competition, the City Does Not Engage in Anticompetitive Behavior

The Plaintiffs allege that IRNE purposely set prices below that of private providers in order to capture market share.

> "In order to gain market share, the City deliberately priced its services to undercut private carriers: ..."[72]

If we assume, for the sake of argument, that the Plaintiffs' allegations are true, as economists we find no cause for concern regarding anticompetitive behavior on the part of the City. Competitors seeking to underprice their competition is what we as a society expect and want from our markets. Wal-Mart is a good example. And Wal-Mart, of course, is hardly unusual.

Underpricing one's competitors is not anticompetitive. We have seen no evidence that the City engages in predatory pricing or other anticompetitive behavior regarding the pricing

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[68] Complaint for Declaratory Judgment (First). Cited previously. Page 9, paragraph 16.

[69] Gray, Mark. Declaration. Cited previously. Page 3, paragraph 8.

[70] City of Portland's Concise Statement of Material Facts Not In Dispute. Cited previously. Page 2, paragraph 8; and Smith, Ralph, of the City of Portland's Office of Finance and Management. Personal Interview. August 5, 2005.

[71] Smith, Ralph, of the City of Portland's Office of Finance and Management. Personal Interview. August 5, 2005.

[72] Plaintiffs' Response To Defendant's Motion For Partial Summary Judgment And Motion For Joinder. Cited previously. Page 9.

for IRNE's services. As I describe in the following subsection, consumers benefit from IRNE's lower prices, which is what we should want and expect from our producers and suppliers, whether they are private or public entities.

G. IRNE's Operations Benefit Consumers and Competition

The Plaintiffs allege that IRNE's operations harm consumers and competition in the market for telecommunications services.

> "[T]he City's actions ... harm the public interest in telecommunications competition in the Portland metropolitan area. The City is exploiting its monopoly control over public ROWs to effectively prohibit normal competition in the markets that the City serves through IRNE."[73]

I find no basis in fact for the Plaintiffs' allegations. Based on our review of the available information and on my professional knowledge of demand, supply and markets, I conclude that IRNE's participation in the market helps promote the public interest and helps protect consumers. IRNE also helps promote competition in the market for telecommunications services in the Portland area.

We must distinguish between the type of "monopoly control" or, more to the point, "the exercise of monopoly control" that violates antitrust laws and harms consumers, from the control that owners have over their property. A homeowner owns his driveway and a factory owner owns her production facility. In these cases, ownership does not constitute anticompetitive behavior in an economic sense, even though the homeowner could lease his driveway to a neighbor and the factory owner could lease her facility to a former competitor. Likewise, the fact that the City controls the ROW does not mean that it exercises monopoly control over the ROW.[74]

The U.S. Federal Trade Commission (FTC) and U.S. Department of Justice (DOJ) describe the necessary (though not sufficient) steps that Plaintiffs should take when making a claim of monopoly power.[75]

- Identify the relevant product, the good or services, at issue

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[73] Complaint for Declaratory Judgment (First). Cited previously. Page 10, paragraph 18.

[74] Not incidentally, the existence of a monopoly in the context of ROW is itself not bad and whether the ROW is owned by the City, another public entity, or a private firm, the monopoly would still exist. For my reasons for these statements, see Baumol, W. J. and A. S. Blinder. 1991. *Microeconomics Principles and Policy*, 5th Edition. Fort Worth, TX: Harcourt Brace Jovanovich. Pages 215-216, G-2, G-5; Nicholson, Walter. 1998. Cited previously. Pages 546, 569; O'Sullivan, Arthur and Steven M. Sheffrin. 2001. Cited previously. Page G-3; Samuelson, Paul A. and William D. Nordhaus. 1992. Cited previously. Page 166, 224, 339-340, 735, 742, G-7; Stiglitz, Joseph E. 1997. *Economics*, 2nd Edition. New York: W.W. Norton & Co. Pages 351, A10, A15.

[75] U.S. Department of Justice and Federal Trade Commission. 1997. *1992 Horizontal Merger Guidelines [With April 8, 1997, Revisions to Section 4 On Efficiencies]*. U.S. Department of Justice and Federal Trade Commission. http://www.ftc.gov/bc/docs/horizmer.htm accessed June 20, 2005.

- Identify the relevant geography, or the area over which the relevant product is traded
- Calculate the market shares of the relevant product in the relevant geography for all market participants

The Plaintiffs have not taken these steps, and their claim of monopoly power, therefore, lacks the necessary analyses and documentation. For example, the Plaintiffs have not identified the relevant product or relevant geography at issue. Even if the Plaintiffs had conducted studies that include these steps, they must, according to FTC and DOJ guidelines, also prove harm to consumers in the form of restricted access to goods or services, or prices for goods and services that exceed the relevant market rates. The Plaintiffs provide no such analysis. In fact, based on the information available to us at this time and on my professional knowledge of demand, supply and markets, I conclude that IRNE's presence in the market for telecommunication services benefits consumers by providing equivalent or superior services at prices equal to or below its competitors.

Comments from IRNE's customers speak to IRNE's superior services and lower prices, relative to its competitors.

Multnomah County

> "With the greater capacity [available through IRNE], the County was ... able to consolidate data centers and downsize some of their organization, thus saving money."
>
> "Multnomah County chose to contract with IRNE for several reasons including that they were able to purchase more bandwidth for comparable money and IRNE offered greater flexibility in network design and the centralization of data centers."
>
> "The County also believes they benefit from having closer communications with other governmental entities where they can explore common goals. For example, the County is currently looking at IRNE for disaster relief. They are exploring using the Gresham IRNE line to transmit and store data should something happen to the Kelly Building. They believe IRNE will offer even more opportunities in the future."[76]

METRO

> "METRO chose IRNE over other providers because of the flexibility it offers at the Pittock Hotel and for the stability of the system. ... The fact that IRNE is a governmental entity did

[76] Holstun, S. 2005. Interview with staff from Multnomah County. August 4.

influence METRO's decision to contract with IRNE. Biedermann [METRO's Director of Information Technology] feels collective endeavors of governmental entities are very important. The collective endeavor of the various entities to operate IRNE keeps them involved with the exchange of information technology."[77]

Multnomah Education Service District (MESD)

> "After entering into their last contract with Qwest, MESD experienced several problems with Qwest. The first of which, Qwest miscalculated the cost of their services and informed MESD that they were running 25-30% over contract. MESD had an extensive list of repairs that Qwest was either slow to fix or simply never addressed."
>
> "MESD contracted with IRNE over another private provider because: 1) they got greater capacity for less money; 2) the reliability of IRNE is much higher; 3) customer services is much better than Qwest; and 4) it is much easier to work with other governmental agencies who understand the needs of government."
>
> "Harrison [MESD Technology Officer] believes IRNE has benefited the MESD and its public purposes. It has created a partnership with other governmental entities and opened the lines of communication between the cities, counties, libraries and other school districts. Because they share common goals, each entity has done better than they could have done individually."[78]

Portland Public Schools (PPS)

> "Robinson [Chief Technology Officer for Portland Public Schools] said PPS experienced high failure rates with Qwest, primarily because they have an aging infrastructure."
>
> "Robinson buys from IRNE versus other providers because IRNE offers the bandwidth that PPS needs at an affordable price and because the system is reliable."
>
> "Robinson believes that he could obtain similar services from other providers, but that they would not have the same system architecture and therefore, might not be as reliable. However,

[77] Holstun, S. 2005. Interview with David Beiderman, METRO's Director of Information Technology. August 3.

[78] Holstun, S. 2005. Interview with Eric Harrison, Multnomah Education Service District's Technology Officer. August 4.

> he does not believe he could get the same service for IRNE's prices."[79]

Port of Portland

> "For purposes of the Port's redundancy needs, Splawn [Communication Services Manager for the Port of Portland] believes there are not a lot of alternatives to IRNE. Qwest is the only private provider that has circuits in the area of the airport, but they have been unwilling to update the circuits to DSL lines."
>
> "The Port primarily contracted with IRNE because they were able to get the redundancy at a reasonable price and they were already a partner in the 800 MHz [radio services for emergency police, fire, and other emergency staff] system. The fact that IRNE is a governmental entity has had the added benefit of helping to expedite things among the agencies."
>
> "Splawn believes the Port benefits from being a part of IRNE in that it has increased interagency cooperation and access to other agencies."[80]

In a deposition taken as part of this case, TWT's vice president and general manager of operations in Portland, Mr. Jon Nicholson, described how IRNE's presence in the market promotes competition and lowers costs for consumers.[81] Mr. Nicholson describes IRNE's beneficial impact on competition and the price METRO paid for their Internet connection:

> "[METRO] put out an RFP [Request for Proposals] utilizing an IRNE connection to the Pittock Block,[82] which then opened up that opportunity to a lot of other providers who wouldn't have been able to build into them. In the end they went to the lower cost provider [ELI]."
>
> "If IRNE had not provided a connection for Metro to the Pittock Block, then their options for connectivity directly into their site would have been fairly limited as far as those who actually had the capital and the network to be able to build into there."

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[79] Holstun, S. 2005. Interview with Scott Robinson, Chief Technology Officer for the Portland Public Schools. August 3.

[80] Holstun, S. 2005. Interview with Wayne Splawn, Communication Services Manager for the Port of Portland. August 9.

[81] Nicholson, Jon. Deposition Transcript. March 22, 2005. In the matter of Time Warner Telecom of Oregon, LLC and Qwest Communications Corporation v. the City of Portland. Pages 78-82.

[82] As I understand, the Pittock Block houses Internet provider and other telecommunications services.

> "As it was, by being in the Pittock Block and by being able to obtain service from IRNE, it opened up the options substantially for them to various players."
>
> "With their options to go to the Pittock Block as opposed to have to take service at their location, that existing revenue stream went away from me, as well as the future revenue stream that, you know, we would have had a far better shot at if they hadn't been able to get to the Pittock Block."[83]

In this case, IRNE's connection to the Pittock Block's Internet hotel promoted competition for METRO's Internet access and helped match METRO with the low-cost provider. But for IRNE's system, METRO might have continued their relationship with TWT at higher rates.

IRNE benefits the City and the jurisdictions that subscribe to IRNE in ways that QCC or TWT apparently cannot. As described above in the statements by IRNE's customers, the relationship between IRNE and the jurisdictions that receive data-transmission services from IRNE is not limited to the telecommunications vendor and buyer. As I understand, many of the jurisdictions with which IRNE has Intergovernmental Agreements (IGA) for data-transmission services also work with the City on other projects. IRNE's communications services facilitate the exchange of information and data between or among jurisdictions working in common on a project. For example, the Port of Portland and the City may utilize IRNE's data-transmission services as part of their participation in a project on regional transportation. QCC or TWT would have no interest in such a project.[84]

Ed Whitelaw

Ed Whitelaw

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[83] Nicholson, Jon. Deposition Transcript. Cited previously. Pages 79-91.

[84] Gray, Mark, Manager of Communications Operations and Engineering for the City of Portland. Personal Interview. August, 12, 2005.